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The Consumer and the Code: A Crosssectional View

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THE CONSUMER AND THE CODE: A CROSS-SECTIONAL VIEW

DANIEL E. MURRAY*

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SALES ASPECTS

I. INTRODUCTION

The adoption of the Uniform Commercial Code in forty-nine states has engendered an outpouring of articles whose number far exceeds that of the reported cases. With a few exceptions,¹ the majority of these articles have approached the Code from the view of the merchant and the lender with virtually no concern for the view of the consumer. This is somewhat surprising because, although few of us are merchants or lenders, all of us are consumers. And after all, without consumers there would be no need for merchants and lenders.

The Code does not define the word "consumer," but it does succinctly define the phrase "consumer goods" as meaning goods which are "used or bought for use primarily for personal, family or household purposes."² Under this definition, the consumer is defined by the purpose of his purchase. On the other hand, the merchant is defined by what he sells or buys or by his skill;

[A] person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.³

This general definition of merchant includes two classes, (a) the person who deals in goods of *the* kind, and (b) those who hold themselves out as having knowledge or skills peculiar to the goods involved. A retail dealer who sold household appliances would meet both definitions; a purchasing agent for a university which is purchasing appliances for its dormitories would meet only the latter.⁴ In addition to the general definition, the Code defines a particular species of merchant as one "who deals in goods of *that* kind"⁵ or as a "merchant with respect to goods of *that* kind."⁶ These

1. E.g., Skilton & Helstad, *Protection of the Installment Buyer of Goods Under the Uniform Commercial Code*, 65 MICH. L. REV. 1465 (1967); Hollander, *Consumer Perspective and Consumer Sales Under the Uniform Commercial Code*, 21 N.Y.U. INTRA. L. REV. 241 (1965-1966). For a collection of consumer-oriented writings, see *THE LAW AND THE LOW INCOME CONSUMER* (C. H. Katz, ed. 1968). See *Consumer Protection Symposium*, 29 OHIO ST. L. J. 593 (1968).

2. UNIFORM COMMERCIAL CODE § 9-109(1) [hereinafter cited U.C.C.].

3. U.C.C. § 2-104(1).

4. U.C.C. § 2-104, Comment 2.

5. U.C.C. § 2-403(2) (emphasis added).

6. U.C.C. § 2-314(1) (emphasis added).

definitional guidelines as to what is a merchant are designed to classify him as a "professional in business."⁷

It is submitted that this "professionalization" of the merchant class is of overriding importance in understanding the intent of the Code when it speaks of good faith of a merchant as consisting of "honesty in fact and the observance of reasonable commercial standards," of "good faith," of "unconscionability," of "implied warranties in sales by merchants in goods of that kind," etc. As a professional, the merchant who knows his wares must be held to a higher degree of legal responsibility for his actions than the unsophisticated consumer with whom he is dealing.

In addition to the above notion of a dichotomy between the merchant and the consumer, it is important to consider the Code as a thoroughly integrated articulation wherein one section will relate to a following or preceding section in the same article or even in different articles. If the lawyer or court uses tunnel vision in looking solely at one section, the purpose of the Code will be perverted. For example, when one begins to consider the warranty sections of the Code he must also consider the rules governing "cure," "insecurity and adequate assurance," "rejection," "acceptance," "revocation of acceptance," etc.

The remainder of this article will deal with the multitude of problems presented by John Consumer's purchase of a refrigerator and a wall-installed air-conditioning unit for his home from the Merchants Appliance Company, and his subsequent credit purchase of a home freezer and "family food plan" from the Hipressure Food Company in accordance with the above transactional outline.

II. FORMATION OF THE SALES CONTRACT

A. *Good Faith and Unconscionability*

The Code imposes upon both the merchant and the consumer the obligation of good faith in every contract or duty in its performance or enforcement.⁸ In addition, the concept of good faith for a merchant "means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."⁹ Neither the merchant nor the consumer may disclaim this good faith obligation by contract; however, they may provide in their contract certain criteria to measure good faith performance if the criteria "are not manifestly unreasonable."¹⁰

Professor Britton has suggested (in regard to a prior version of Article 3) that the Code, in providing that the merchant must observe reasonable commercial standards of fair dealing in the trade, has invited the courts to make invidious distinctions between various trades.¹¹ For

7. U.C.C. § 2-104, Comment 2.

8. U.C.C. § 1-203.

9. U.C.C. § 2-103(1)(b).

10. U.C.C. § 1-102(3).

11. Britton, *Holder in Due Course—A Comparison of the Provisions of the Negotiable*

example, a court might suggest that there is a lower standard of fair dealing in the used car trade than in the furniture trade and that the honesty of the merchant is to be measured by a higher or lower standard dependent upon his trade. On the other hand, it is submitted that in construing the phrase "honesty in fact and the observance of reasonable commercial standards" the courts should note that the use of the conjunction "and" requires the merchant to be both honest in fact *and* to observe the standards of fair dealing in his trade. The real purpose of this rule would seem to be to give the courts some kind of *objective* standard in order to test the merchant's *subjective* assertion that he was in good faith and was honest in the particular transaction. Professor Mentschikoff has demonstrated that the New York courts have in fact been using this reasonable commercial standard even though the judicial language has been couched in the terms of good faith from a subjective viewpoint.¹² The Code by commingling subjective good faith and an objective standard has given the courts a workable tool to evaluate the ephemeral concept of good faith with which the courts have been wrestling for many years.

One acute observer has opined that good faith is an "excluder" phrase in the sense that a court will label certain conduct as bad faith, rather than attempt to define what is good faith.¹³ It is often easier to define and apply a negative than a positive. However, the Code takes a more positive approach in stating that a merchant must observe "reasonable commercial standards of *fair dealing* in the trade."¹⁴ Involved in this "fair dealing" notion is the level of sophistication of the seller and buyer. Let us assume that John Consumer is illiterate (or literate only in a foreign language) and signs a purchase contract and a security agreement furnished by Merchants Appliance Company for the credit purchase of an air-conditioner and refrigerator. John does not have the two agreements read to him by a relative or friend, and later discovers that the written agreement does not contain the terms orally agreed upon. The traditional view has been the courts will not protect John when he asserts that the agreements were obtained by fraud because he could have had the agreements read to him and was not free from negligence in protecting himself.¹⁵ The author suggests a different approach, as follows: Is it good faith—is it "fair dealing in the trade"—for the merchant to have an illiterate sign a contract which does not incorporate the oral agreement of the parties regardless of the fact that the illiterate could have had the agreement read to him? In sum, the focus of the test should be on the actions of the

Instruments Law with those of Article 3 of the Proposed Commercial Code, 49 Nw. U.L. REV. 417, 431-432 (1954).

12. 1 N.Y. LAW REVISION COMM'N REP. 213-240 (1954).

13. Summers, "Good Faith" in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968).

14. U.C.C. § 2-103(1)(b) (emphasis added).

15. The facts outlined would give rise to a "personal" defense which would not be valid against a holder in due course of any negotiable instrument signed by John Consumer. See U.C.C. § 3-305(2)(c) and Comment 7.

merchant seller rather than on the failure to act of the consumer buyer. If this test were used, it would not impose any hardship upon the majority of honest merchants. The dishonest merchant, of course, would be adversely affected, and he ought to be.

Closely related to the good faith notion is the reverse concept that if a court finds as a matter of law that the contract or part of a contract was unconscionable at the time it was made, the court may refuse to enforce the contract or may invalidate an unconscionable clause and enforce the remainder. The court may also limit the application of an "unconscionable clause as to avoid any unconscionable result."¹⁶ The Comments note that:

The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. . . .¹⁷

Applying the unconscionability rule to the facts of our hypothetical problem, if Merchants Appliance Company should orally represent to John Consumer that the refrigerator is new, but nothing was stated in the written contract as to its being new and the refrigerator is in fact a used one, a disclaimer of all warranties asserted by Credit Appliance Company as a defense could be invalidated as being unconscionable and in bad faith or could be limited in application by a holding that it does not apply to the oral representations of newness. Under either approach, a court could avoid overreaching by the dealer.

Whatever may be said as to the vagueness of the concept of "unconscionability" (and much has been said),¹⁸ it must be noted that whenever the question is raised "the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination."¹⁹ The commercial evidence is to be heard by the trial judge without a jury, and he must make the ultimate determination as to the question of unconscionability. Hence, even though the standard may be vague, Merchants (in our hypothetical problem) would be protected from whims of a consumer-oriented jury.²⁰ If trial court judges have been able to apply vague "due process" concepts in criminal matters and "unconscionable conduct" in equity matters for many years, they should not have any great problems under the Code.²¹

16. U.C.C. § 2-302(1).

17. U.C.C. § 2-302, Comment 1.

18. The unconscionability rule of the Code has been severely criticized because it fails to define the concept and the Comments to section 2-302 are mere circumlocutions. Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967). For a more temperate view see Skilton & Helstad, *Protection of the Installment Buyer of Goods Under the Uniform Commercial Code*, 65 MICH. L. REV. 1465, 1473 (1967). See also Comment, 114 U. PA. L. REV. 998 (1966) and Comment, 109 U. PA. L. REV. 401 (1961).

19. U.C.C. § 2-302(2).

20. U.C.C. § 2-302, Comment 3.

21. Davenport, *Unconscionability and the Uniform Commercial Code*, 22 U. MIAMI L. REV. 121 (1967).

As might be surmised, almost all of the reported consumer cases which have arisen under the unconscionability defense have primarily involved the unconscionable behavior of a vendor of consumer goods in obtaining one-sided credit advantages in installment payment contracts rather than the quality of the consumer goods. These cases are discussed in a subsequent section.²²

B. *Written Formalities—Statute of Frauds*

The Code provides that a contract for the sale of goods for a price of five hundred dollars or more is not enforceable unless it is written and signed by the person against whom the contract is asserted. The written contract is valid even though terms are left out or are incorrectly stated; however, the written contract cannot be enforced "beyond the quantity of goods shown in such writing."²³ As a result, John Consumer could be held liable on an oral contract to purchase the refrigerator and air-conditioner from Merchants Appliance Company if the total sales price did not equal five hundred dollars. Conversely, if the total sales price were in excess of this amount, the contract would have to be in writing and signed by John Consumer to bind him. If the written contract listed the refrigerator and air-conditioner, Merchants Appliance Company would be prevented from asserting that John Consumer had contracted to purchase additional appliances whose listing was inadvertently omitted.

If we assume that John Consumer orally agreed to purchase, for a total price exceeding five hundred dollars, the above appliances together with other appliances and that the Credit Appliance Company actually delivered the refrigerator and air-conditioner, John Consumer would be liable only for the purchase price of those goods "which [had] been received and accepted."²⁴ It should be noted that if, after a reasonable opportunity to inspect the goods, John Consumer should reject the refrigerator and the air-conditioner on the grounds that they did not conform to the contract of sale, he would not be deemed to have accepted them under the statute of frauds exception and would not be liable for their purchase price.²⁵ It may be asked whether John Consumer's right to reject requires a bona fide belief that the goods do not conform to the contract or whether he may refuse to accept them in the first instance if he has changed his mind between the time that he ordered the goods and the actual delivery. The answer under the Code is not entirely clear. The statute of frauds rule²⁶ makes a cross-reference to section 2-606, which defines the concept of acceptance. Under this latter section in conjunction with section 2-602, it would appear that any revocation of acceptance would have to be based

22. See page 56 *infra*.

23. U.C.C. § 2-201(1).

24. U.C.C. § 2-201(3)(c).

25. U.C.C. § 2-606.

26. U.C.C. § 2-201(3)(c).

upon the fact that the goods did not conform to the contract. However, if for any reason John Consumer should reject the tender upon delivery under section 2-602 this would negate any idea of "acceptance," and he would not be liable under the oral contract. It may be argued that a "refusal of tender" is just another way of expressing a "rejection" of a tender, and that under section 2-602 the rejection must be rightful or the buyer may be held liable for breach of contract. It is suggested that the concept of rejection in section 2-602 presupposes the existence of a valid contract of sale, not a case involving an oral contract wherein the statute of frauds may be a defense. If the rule is otherwise, it deprives the word "accepted" of any meaning.

Defaulting consumers are also concerned with a new principle adopted by the Code, namely that if the consumer is sued by the merchant and the defendant-consumer "admits in his pleading, testimony or otherwise in court that a contract for sale was made,"²⁷ the contract may be enforced. However, the contract may not be enforced "beyond the quantity of goods admitted."²⁸ No one would quarrel with this rule, but how practical is it? If the local rules of procedure permit a motion to dismiss for affirmative defenses appearing on the face of the plaintiff's complaint, one may never get into court. Would pre-trial discovery or discovery procedure before suit is filed which resulted in a deposition satisfy this test? The Comments make no mention of depositions or interrogatories, and courts may give this rule a narrow construction.²⁹

The statute of frauds section of the Code has also made a modification of the part performance rule regarding the payment of part of the purchase price. Let us assume that John Consumer orally purchased a refrigerator, a stove and an air-conditioner, each appliance having a purchase price of \$250. John paid \$250 of the total purchase price of \$750, but Merchants Appliance Company refuses to deliver the three appliances. Under pre-Code law John would be able to enforce the contract for all three appliances on the grounds of part performance. Now, if the court can make a just apportionment of the agreed purchase price, John can only recover one of the appliances.³⁰ If John had paid only \$125 it would be impossible to make a "just apportionment" of the money paid toward any of the appliances, and John could not enforce the contract. This view has been followed by a lower Pennsylvania court, but rejected by a lower New York court. In the Pennsylvania case³¹ the buyer paid \$100 down on two vats selling for a total of \$1,600 and the court said there could not be any apportionment. In the New York case³² the buyer paid \$25 down

27. U.C.C. § 2-201(3)(b).

28. U.C.C. § 2-201(3)(b).

29. *E.g.*, FLA. R. CIV. P. 1.110(d). *See* W. HAWKLAND, SALES AND BULK SALES 31-32 (2d ed. 1958).

30. U.C.C. § 2-201, Comment 2.

31. *Williamson v. Matz*, 11 Pa. D. & C.2d 33 (1956).

32. *Star v. Freeport Dodge, Inc.*, 54 Misc. 2d 271, 282 N.Y.S.2d 58 (N.Y. 1st Dist. Ct. 1967).

toward the purchase of a car and the court held in favor of the buyer. It is submitted that the New York court is clearly wrong; it is looking at the U.C.C. with Uniform Sales Act spectacles.³³

C. *Modification, Rescission and Waiver*

In a consumer sales contract, it is commonplace for the merchant to make additional promises to the consumer after the delivery of the goods. In the past, the merchant has been able to welch on his promises on the theory that they were not supported by a present consideration. The Code has eliminated this defense by providing that an agreement to modify a sales contract "needs no consideration to be binding."³⁴ In addition, a written contract can be modified by a subsequent oral agreement. The merchant's written form contract may provide that it cannot be orally modified or rescinded, but this clause is not binding upon the consumer unless he separately signs it.³⁵ Signing in this context would at least require the consumer to initial the clause in the margin of the contract.³⁶ It is hazarded that this separate signing, which will draw the attention of consumers to the clause (the obvious intention of the requirement), may result in a consumer's refusal to sign, with the concomitant result that the merchant will have no legal defense to a consumer's claim of modification. If consumer resistance to signing these clauses becomes widespread, merchants will probably abandon the use of these clauses in their form contracts.

One caveat to the foregoing discussion must be noted. If the *modified* sales contract provides for a sales price of five hundred dollars or more, then the modification must also be in writing where the contract is executory in the sense that neither delivery of goods nor payment of money has occurred.³⁷

III. SALES ON APPROVAL

Occasionally, merchants will sell consumer goods on a sale on approval or on a trial or satisfaction basis, and the consumer will be concerned with his rights and duties under such a contract. Prior to the Code there was a conflict as to whether the buyer's approval had to be based upon a reasonable buyer's approval or upon the purely subjective approval of each particular buyer.³⁸ The Code does not decide this question, but it would appear that a buyer's disapproval would have to be in good faith. This may act as a brake upon the exercise of disapproval by buyers who "purchase" with no intention of ever consummating the sale.

33. R. DUESENBERG & L. KING, *SALES AND BULK TRANSFERS* § 2.04[5][b] (1966).

34. U.C.C. § 2-209(1).

35. U.C.C. § 2-209(2).

36. U.C.C. § 1-201(39), Comment 39.

37. U.C.C. § 2-209(3).

38. See *RESTATEMENT OF CONTRACTS* § 265 (1960) and 1 S. WILLISTON, *SALES* 483-488 (1948).

Any goods which are possessed by a consumer buyer on a sale on approval are not subject to the consumer's creditors until he has accepted them. This rule may be of more concern to merchants than to consumers.³⁹

In the absence of any clause to the contrary in the agreement, risk of loss and title does not pass to John Consumer until he accepts the goods.⁴⁰ John's use of the goods in a manner consistent with the purpose of the trial will not constitute an acceptance. However, John's failure to "seasonably" (within a time specified in the agreement or within a reasonable time when no time is specified)⁴¹ notify Merchants Appliance Company of his election to return the goods will constitute an acceptance.⁴² As a practical matter, it is ventured that most merchants will clearly specify a cut-off date in the agreement.

If the goods consist of more than one unit or item, John Consumer must reject all of the units or items if any are unsatisfactory, because his "acceptance of any part is an acceptance of the whole."⁴³ However, the sale may be in the form of alternatives. For example, John Consumer could be given possession of two different makes of electric can openers, from which he is to make a selection. In this case, the approval of one would not, of course, constitute an approval of both.⁴⁴

The Code takes the rather dogmatic approach that "after due notification of election to return, the return is at the seller's risk and expense but a merchant buyer must follow any reasonable instructions."⁴⁵ The Comments stress this view by stating that the notice of election to return by the buyer in a sale on approval is sufficient to relieve the non-merchant buyer of "any further liability."⁴⁶ It is submitted, however, that John Consumer, in spite of both of these statements, would be liable if he failed to exert reasonable care for the "disapproved" goods prior to return or was careless in the actual return. A lack of reasonable care—a "don't care" attitude—would hardly meet a standard of good faith, and the Comments note that the provisions of both the Code and of the contract on this point "must be read with commercial reason and with full attention to good faith."⁴⁷ This is merely a reiteration of the all-embracing good faith rule which runs throughout the Code.

IV. BUYER'S LIABILITY FOR NON-ACCEPTANCE OR REPUDIATION

John Consumer has signed an agreement with Merchants Appliance Company to purchase the air-conditioner and refrigerator. The day before delivery John learns that a competitor of Merchants is selling the

39. U.C.C. § 2-326(2).

40. U.C.C. § 2-327(1)(a).

41. U.C.C. § 1-204(3).

42. U.C.C. § 2-327(1)(b).

43. U.C.C. § 2-327(1)(b).

44. U.C.C. § 2-327, Comment 1.

45. U.C.C. § 2-327(1)(c).

46. U.C.C. § 2-327, Comment 4.

47. *Id.*

identical goods for considerably less. John telephones Merchants and tells it that "the deal is off." Prior to the Code, Merchants could sue, but its remedy was illusory because the general rule was that Merchants could only recover as damages the difference between the market price of the goods and the sales price to John.⁴⁸ If these two prices were the same, Merchants could only recover nominal damages; if the contract sales price was less than market price, again Merchants could recover no real damages. As a result of this pre-Code rule, purchase contracts in reality bound only the merchant and not the consumer.

The Code has changed these one-sided-duty contracts. Today, Merchants could still sue John for the difference between the market price at the time and place of tender and the unpaid contract price.⁴⁹ In addition, John would be liable for any incidental damages such as expenses incurred in the transportation, care and custody of the goods in connection with the return or resale of the goods after the buyer's breach.⁵⁰ However, if this remedy would not place Merchants in as good a position as performance would have, then Merchants may recover the profit, including reasonable overhead, which Merchants would have made from the sale if John had performed, together with the incidental damages noted above and allowance for costs reasonably incurred, but less expenses saved.⁵¹ Under this rule, Merchants at the very least would be able to recover the difference between the costs of the goods to it and the contract price to John—in effect, Merchants is given the benefit of the bargain.

It is doubtful that many retail vendors will take advantage of this rule because the customer ill-will engendered by numerous suits might exceed the "profits" which are recovered by suit. However, lawyers concerned with consumer rights must weigh this section when their clients are faced with contentious retail merchants.

V. RISKS OF LOSS PRIOR TO DELIVERY

Occasionally, the consumer will be concerned with risks of loss of the goods prior to their being delivered to him. For example, John Consumer may purchase a refrigerator and air-conditioner from Merchants Appliance Company by paying cash or by making a down payment and giving a purchase money security interest to the vendor. John requests Merchants to retain the goods for a few days until John moves into his new home. The following things may happen to the goods while they are in possession of Merchants: (a) the goods purchased by John may be destroyed by fire or windstorm; (b) a judgment lien creditor of Merchants may levy execution on these goods; and (c) Merchants may go into volun-

48. U.C.C. § 2-708, Comment 2.

49. U.C.C. § 2-708(1).

50. U.C.C. § 2-710.

51. U.C.C. § 2-708(2).

tary or involuntary bankruptcy, and the trustee in bankruptcy will claim the goods purchased by John. Each of these problems will be discussed in order.

The Code provides that John Consumer has an insurable interest in the refrigerator and air-conditioner at the point that the sale is made of identified existing goods, *e.g.*, those selected directly from the showroom floor or taken from stock and designated by the vendor as goods to which the contract refers.⁵² Hence, if John's own insurance policy is broad enough to cover these undelivered goods (perhaps a rare case) he is protected from fire and windstorm loss when the goods are destroyed in the Merchants Company's store. Of more practical importance, the Code provides that the risk of loss in a sale by a merchant to a buyer does not pass the risk to the buyer in this fact pattern until delivery is made to the buyer.⁵³ The rationale is that the merchant vendor will probably carry insurance to cover goods in his possession, while the consumer buyer would not usually have this coverage.⁵⁴ Of course, if the merchant is not insured (or underinsured) and is rendered insolvent as a result of the fire or windstorm, the ultimate loss will fall on John Consumer.

Under the pre-Code fraudulent conveyance statutes found in most states, a creditor of Merchants could claim that the retention of possession of the goods by Merchants after the sale to John Consumer was fraudulent, and that he could levy on the goods. The Code incorporates this pre-Code law, but it provides that "retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale . . . is not fraudulent."⁵⁵ It would seem that Merchants' agreement to retain possession for a few days until John Consumer moved into his new home would satisfy the "good faith and current course of trade" criteria of this section, and John should be able to recover the goods from the attaching lien creditor.

If we assume that the refrigerator and air-conditioner were taken from Merchants' showroom floor or were designated as the goods sold to John when taken from Merchants' stock, John Consumer, having paid all or a portion of the price, could recover the goods from the trustee in bankruptcy, provided that Merchants became insolvent within ten days after receipt of the first installment on their price and provided that John makes a continuing tender of any unpaid portion of the purchase price.⁵⁶ In the event that the insolvency did not occur within this limited ten-day period, he will be relegated to the position of a creditor under the provisions of article nine.⁵⁷

52. U.C.C. § 2-501(1)(a) and (b).

53. U.C.C. § 2-509(3).

54. U.C.C. § 2-509, Comment 3.

55. U.C.C. § 2-402(2).

56. U.C.C. § 2-502(1).

57. U.C.C. § 2-502, Comment 2.

VI. EXPRESS AND IMPLIED WARRANTIES OF TITLE AND QUALITY

A. *Warranties of Title and Cure*

John Consumer need have little concern for the possibility that Merchants Appliance Company did not have good title to the new air-conditioner and new refrigerator which it has sold to him because Merchants likely acquired these goods from a wholesaler or jobber who in turn acquired them from a manufacturer. Any security interest created by Merchants in its purchase of these goods from its supplier would be cut off by the sale to John as a buyer in ordinary course of business.⁵⁸ However, if John purchased a used, trade-in air-conditioner and refrigerator from Merchants, Merchants might not have good title if it received these units from a consumer who had purchased them on a purchase money security interest from another retail merchant. An unsatisfied purchase money security interest on consumer goods will not be cut off, even though a financing statement has not been filed, upon a trade-in of the unit to Merchants for purposes of re-sale,⁵⁹ and courts might hold that John's purchase does not fit within the scope of section 9-307(2) and therefore is subject to the unfilled security interest. If the first retail vendor filed his security interest, there would be little doubt that John takes subject to it.⁶⁰ In this latter case, a breach of warranty of title question would arise.

To take a more commonplace example, assume John Consumer purchases a used car from a new or used automobile dealer. The dealer applies for a new car title in the name of John Consumer, and then it is discovered that a third person has title to or a security interest in the automobile. Under the Code, the automobile dealer warrants that the title which he conveyed was good and its transfer rightful and that the title is free from any security interest or other lien or encumbrance of which John Consumer had no *actual* knowledge at the time of sale.⁶¹ This warranty is not labeled as an implied warranty; hence a broad disclaimer clause in the contract of sale disclaiming all expressed and implied warranties will not be sufficient to disclaim a warranty of title.⁶² The automobile dealer may, of course, disclaim any warranty of title, but the sales agreement must use specific language in order to do this. Of course, if John Consumer knows or has reason to know that the automobile dealer does not claim title in himself or that he is selling only such right or title that a third person may have, then there will not be a warranty of title. For example, if the automobile dealer told John Consumer that he (the dealer) did not own the

58. U.C.C. § 9-307(1). See *Everett Nat'l Bank v. Albert Deschuiteneer*, 37 U.S.L.W. 2076 (Sup. Ct. N.H. July 17, 1968).

59. U.C.C. § 9-307(2). *U.G.I. v. McFalls*, 18 Pa. D. & C.2d 813 (C.P. Lancaster County 1959).

60. U.C.C. § 9-307(2).

61. U.C.C. § 2-312(1)(a) and (b). For the consumer's rights against the third party security interest holder see Comment, *Section 9-103 and the Interstate Movement of Goods*, 9 B.C. IND. & COM. L. REV. 72 (1967).

62. U.C.C. § 2-312, Comment 6.

car but was only selling it for another on a "consignment basis" as his agent, then a court could hold that there was no warranty by the dealer.⁶³

The breach of warranty of title occurs upon tender of delivery of the automobile to John Consumer regardless of the fact that John may not be aware of the defective title, and he must commence suit against the dealer within a four-year period from the date of tender.⁶⁴ However, the original sales contract may reduce this period of limitation to one year, and John Consumer's lawyer must examine the sales contract for this possibility.⁶⁵ John Consumer's lawyer must also be concerned with notice to the dealer of the breach of warranty. If John Consumer becomes aware of the breach before he accepts the tender of delivery, he may reject the tender and must notify the vendor of his rejection within a reasonable time.⁶⁶ If he discovers the defective title after he has accepted the car, John may revoke his acceptance, and again he must give the vendor notice within a reasonable time.⁶⁷ The Comments note that this concept of reasonable time in giving the notice of breach of warranty is to avoid misleading or prejudicing an innocent vendor—one who did not know that the title was defective. This same consideration need not be extended to a bad faith vendor, and "in such case the 'reasonable time' for notice should receive a very liberal interpretation."⁶⁸

The good or bad faith of the car dealer *may* have further significance. Should the vendor have the right to "cure" the defective title, assuming that he is able to so do? Section 2-508 of the Code states that when the buyer rejects any non-conforming tender of delivery and the time for performance has not expired, the seller may "seasonably" notify the buyer of his intention to cure and then make a conforming delivery within the contract time. This sub-section would not seem applicable because the "time for performance" has expired upon delivery to John Consumer. Sub-section 2 of 2-508 seems to have some relevancy. It provides that when a buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable, the seller may "seasonably" notify the buyer and have a further reasonable time to substitute a conforming tender. It is believed that courts should hold that a bad faith vendor would not have reasonable grounds to believe that his buyer would knowingly accept a defective title, and the seller should be barred from asserting a *right* to cure the title. In this situation, however, courts should hold that the seller has a *duty* to cure at the option of the buyer. The buyer may be happy with the quality of the automobile and might prefer to keep it upon the seller's cure of the defect in title.

The good faith vendor who has breached his warranty presents a

63. U.C.C. § 2-312(2).

64. U.C.C. § 2-725(1); and U.C.C. § 2-312, Comment 2.

65. U.C.C. § 2-725(1).

66. U.C.C. § 2-602, Comment 1.

67. U.C.C. § 2-608(1) and (2).

68. U.C.C. § 2-312, Comment 2.

stronger case for the application of section 2-508 as a matter of *right*. The good faith vendor who believes that he has title has reasonable grounds to believe the tender would be acceptable. On the other hand, his reasonable grounds to believe are based upon an erroneous premise, and are courts to judge the reasonableness of his grounds upon the true facts or upon what he believes the facts to be? Cases prior to the Code gave the vendor a right to cure the defective title when little or no material delay or damage would occur to the buyer,⁶⁹ and this Code section may be an inartful articulation of the same rule. The Comments state that this provision is designed to prevent injustice to the seller because of a "surprise rejection" by the buyer seemingly on a question of quality of the goods;⁷⁰ the Comments do not mention the word "title." The rejection by the buyer is hardly a matter of surprise. The surprise in the case of the good faith seller is surprise that the facts are not as he thought them to be, and this is not the fault of the buyer or any injustice to the seller when the buyer rejects. There may be the following countervailing argument: assuming that the vendor has acted in good faith, should not the buyer be forced to act in good faith⁷¹ in demanding his "rights?" Should not a court hold that it is unjust to the seller to take back the automobile and refund the purchase price when he is willing to cure the defect and to respond for any "real" damages incurred by the buyer? The buyer, under this approach, will get exactly what he bargained for.

Lawyers for consumers are cautioned that there have been no cases interpreting this section. Additionally, the authorities are unsure as to its application in the title area.⁷²

If we assume that the seller may, under certain circumstances, have a right to cure the defective title, another section of the Code comes into play. After the automobile dealer has notified John Consumer of his intent to cure the defective title, John has the right to demand in writing of the dealer that it give "adequate assurance of due performance."⁷³ John may also suspend his own payments on chattel paper which is still held by the dealer.⁷⁴ (Whether he is able to suspend payments to a finance company which has received the paper from the dealer is touched upon in another part of this article.)⁷⁵ If the dealer fails to respond by promising adequate assurance within thirty days after he receives the demand from John, this will constitute a repudiation of the contract.⁷⁶

If the dealer is a reputable company, adequate assurance may con-

69. Hawkland, *Curing on Improper Tender of Title to Chattels: Past, Present and Commercial Code*, 46 MINN. L. REV. 697 (1962).

70. U.C.C. § 2-508, Comment 2.

71. U.C.C. §§ 1-102(3) and 1-203.

72. Compare Hawkland, note 69 *supra* with R. DUESENBERG & L. KING, *SALES AND BULK TRANSFERS UNDER THE UNIFORM COMMERCIAL CODE* § 5.05(2) (1966).

73. U.C.C. § 2-609(1).

74. U.C.C. § 2-609(1).

75. See page 64 *infra*.

76. U.C.C. § 2-609(4).

sist simply of a written promise to cure the defect. Conversely, if the dealer is a fly-by-night, adequate assurance may consist of an indemnity bond posted by an indemnity company and paid for by the dealer.⁷⁷ The Code does not define the standard for determining what is "adequate assurance," but simply states that it is "subject to the . . . test of factual conditions" in a commercial setting.⁷⁸

B. *Damages for Breach of Warranty of Title*

The Code broadly states that the damages for breach of warranty are "the difference at the time and place of acceptance between the value of the goods and the value they would have had if they had been as warranted," unless special circumstances show proximate damages of a different amount.⁷⁹ This subtraction standard is easily applicable in the case of a breach of warranty of quality, but it becomes difficult to apply in the case of a breach of warranty of title. If we assume that the vendor will not be permitted by a court to cure the defective title or is unable to do so (if permitted), then the buyer should be able to revoke his acceptance and return the goods to the seller who should then be liable for the entire purchase price. In the majority of pre-Code cases, the seller was not permitted to deduct the use value (or depreciation) from the sales price which he had to return to the buyer.⁸⁰ On a similar basis, if the true owner of the chattel removed the chattel from the possession of the buyer, then the seller was liable for the purchase price to the buyer. The Code's subtraction formula is applicable to these situations; the "value" at the time and place of acceptance should ordinarily be considered as being zero, while the "value" they would have had if they had been as warranted should be the purchase price. This application would result in the same damages as were recoverable prior to the Code. If we say that the value of the goods is to be determined "at the time and place of acceptance,"⁸¹ this language would tend to show that the seller may not deduct any use or depreciation value for the time that the goods were in the hands of the buyer; the "time and place of acceptance" would appear to be a cut-off date in the formula.

In addition to the above standard of damages, the buyer may also be entitled to recover incidental and consequential damages growing out of the breach of warranty.⁸² For example, should the buyer expend money in curing the defect or be deprived of possession for a period of time by

77. U.C.C. § 2-609, Comment 4.

78. *Id.*

79. U.C.C. § 2-714(2).

80. Hawkland, note 69 *supra*.

81. U.C.C. § 2-714(2). If the buyer justifiably revokes his acceptance because of breach of warranty of title, he may recover the purchase price which he paid, purchase replacement goods ("cover") and then recover the difference between the cost of cover and the contract price together with any incidental damages. *See* U.C.C. §§ 2-711(1), 2-712 and 2-715.

82. U.C.C. §§ 2-714(3) and 2-715.

a true owner who has replevied the goods, or should he be put to additional expense in purchasing substitute goods as "cover"⁸³ for the original goods, all of these expenses could be recovered from the seller.

In the event that the breach of warranty comes to the attention of the buyer before he has paid the entire purchase price to the seller, the buyer may deduct all or any part of the damages resulting from the remaining unpaid purchase price.⁸⁴ In this factual setting, the buyer would cease making all payments.

C. *Warranties of Quality*

1. INTRODUCTION

From a casual reading of the plethora of law review articles, notes and comments it would appear that almost every retail sale of consumer goods results in injuries or death to the consumer. This overemphasis on the unusual has resulted in a slighting of the usual, and little attention has been paid to the rights of the consumer in getting what he bargained for—satisfactory goods—which do not, in the vast majority of cases, cause injury. The remainder of this section will deal exclusively with the latter aspect of warranties.

In any given sales transaction, the merchant may give express warranties, and the law may also impress implied warranties on the sales transaction. The two kinds of warranties will often overlap in the transaction, and it will be unnecessary in most cases for the courts to draw a demarcation line between them. However, when the warranties are inconsistent or when there is a disclaimer of one kind of warranty or the other, it becomes important to label them in order to determine which warranty has survived the inconsistency or the disclaimer. In addition, most courts and lawyers have been in the habit of dividing warranties into express and implied, and it is difficult to overcome this propensity.

2. EXPRESS WARRANTIES, DISCLAIMERS AND PAROL EVIDENCE

Let us assume that Merchants Appliance Company's salesman told John Consumer that a particular air-conditioner on the showroom floor would cool *X* number of cubic feet to *Y* degrees in John's house. John looked at the machine, and the salesman said that John could have the exact model number for a certain price. The air-conditioner is then delivered and installed. John discovers that it will not cool in the manner represented and that the company has given him a different model. Let us further assume that the sales invoice contains a statement in small print at the bottom that "there are no express warranties in the sale of the goods except as stated on the invoice." John complains to Merchants, and it relies on the statement on the invoice as a defense. It would appear

83. U.C.C. § 2-712, Comment 4; U.C.C. §§ 2-715(2)(a) and 2-716(3).

84. U.C.C. § 2-717.

on these assumed facts that Merchants' salesman made an affirmation of fact or promise as to the cooling properties of this unit which becomes part of the basis of the bargain, an express warranty.⁸⁵ In addition, Merchants, by describing the machine by the model number and by showing John a "sample"⁸⁶ showroom model, also expressly warranted that he would receive an air-conditioner of that "description"⁸⁷ and that it would conform to the sample seen by John, assuming that the description and the sample were part of the basis of the bargain. (The presumption is that they were part of the basis of the bargain.⁸⁸) The "basis of the bargain" test is not the equivalent of the pre-Code rule that the buyer had to show reliance on the statements of the seller in order to establish an express warranty.⁸⁹ Reliance need not be shown to constitute any particular statement of the vendor as part of the bargain. Of course, these different tests may have the following same result in any particular case: if the buyer did not rely it might not be a basis of the bargain. However, this change in thrust becomes particularly important in the case of modification of the contract. For example, assume that John Consumer has paid cash for the air-conditioner and the salesman has given him a receipt for the payment. The salesman then makes additional affirmations or statements about the performance of this air-conditioner. These statements are modifications of the original sales contract and become part of the basis of the bargain even though, of course, there is no reliance (because the sale is already consummated) and even though there is no additional consideration given by John for this affirmation.⁹⁰

The question remains as to the efficacy of the attempted disclaimer on the invoice; the Comments note that a disclaimer clause in the form suggested would not be effective to negative the three warranties given.⁹¹ This theme is further amplified in section 2-316(1) which states that words or conduct which indicate the creation of an express warranty and words or conduct tending to negate or limit an express warranty shall be construed wherever reasonable as consistent with each other, but negation is inoperative to the extent that this construction is unreasonable.

If John Consumer signs the purchase invoice upon delivery, and the invoice does not contain any model number, description or any statement about the cooling qualities of the unit, how can parol evidence be brought in? The Code has broadened the orthodox parol evidence rule. Any terms of a written agreement "which are intended by the parties as a final expression of their agreement" may not be contradicted by evidence of a prior or contemporaneous parol agreement.⁹² However, these agreed-

85. U.C.C. § 2-313(1)(a).

86. U.C.C. § 2-313(1)(c).

87. U.C.C. § 2-313(1)(b).

88. U.C.C. § 2-313, Comment 6.

89. U.C.C. § 2-313, Comment 3.

90. U.C.C. § 2-313, Comment 7 and U.C.C. § 2-209.

91. U.C.C. § 2-313, Comments 1 and 4.

92. U.C.C. § 2-202.

upon written terms may be "explained or supplemented"⁹³ by a course of dealing (prior transactions between these parties)⁹⁴ or usage of the trade⁹⁵ or by a course of performance between the parties in carrying out other parts, if any, of their contract.⁹⁶ In addition, parol evidence of "consistent additional terms" can be brought in "unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement."⁹⁷ Under the assumed facts, inasmuch as the invoice did not describe the air-conditioner by model number (as distinguished from a serial number) or state its cooling properties, parol evidence of these matters would be termed "consistent" and could be introduced.

The following limitation on the above must be noted: if the court finds that the writing was intended also as a complete and exclusive statement of the terms of the agreement, it may not permit the use of parol evidence.⁹⁸ What should be the result under our assumed transaction if the sales invoice states that "this sales invoice is a complete, final and exclusive statement of the sale and all prior and contemporaneous oral agreements are merged herein and this invoice may not be modified, explained or supplemented except by written agreement?" If courts were to give effect to the literal meaning of these words, it would behoove Merchants to describe goods as briefly as possible, *e.g.*, "one X brand air-conditioner" without any model number, year of manufacture, etc. This vague description coupled with the integration clause would then fit within the Comment view that "if the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact."⁹⁹ Under this approach, the consumer must insist that any written evidence of the sales contract clearly spell out the affirmations regarding the qualities and description of the goods (when the written agreement has a boiler-plate integration clause), or that the agreement rest entirely in parol form.

3. EXPRESS WARRANTIES OF PERFORMANCE UNDER A GUARANTY PERIOD

Today, many kinds of consumer hardgoods (*e.g.*, automobiles, television sets, air-conditioners, washers and dryers, etc.) are sold under an agreement whereby the manufacturer (and the dealer) will "guaranty" the goods by agreeing to repair or replace defective parts within a specified guaranty period. Neither the express nor the implied warranty sections of the Code even recognize the existence of this commonplace warranty

93. *Id.*

94. U.C.C. § 1-205(1).

95. U.C.C. § 1-205(2).

96. U.C.C. § 1-205(3).

97. U.C.C. § 2-202(b).

98. U.C.C. § 2-202(b).

99. U.C.C. § 2-202, Comment 3.

agreement, and only two sections make passing reference to it. Section 2-725(2) provides that a breach of warranty occurs upon tender of delivery in the normal case. However, if the warranty "explicitly extends to future performance of the goods" and discovery of the breach must await the time of performance, then the cause of action accrues when the breach is or should have been discovered. Section 2-719(1)(a) provides that the sales agreement may limit or alter the measure of damages by limiting the buyer to a return of the goods and repayment of the price by the seller or to repair and replacement of non-conforming goods or parts. It should be noted that any attempt to limit consequential damages for injury to the person in the sale of consumer goods is *prima facie* unconscionable, "but limitation of damages where the loss is commercial is not."¹⁰⁰ Under this latter rule, it would be perfectly permissible for the form sales contract of an automobile dealer to provide that its warranty to repair and replace defective parts during the warranty period is in lieu of all other remedies by the consumer buyer for any consequential damages for loss of use of the automobile while it is being repaired.

These express warranties of performance raise additional problems dealing with disclaimers. A Virginia court has held that a new car warranty which provided that it "was in lieu of all other warranties" had the effect of excluding an implied warranty of fitness for a particular purpose. The case was not controlled by the Code, but the court ruled that the Code had made no change in this rule.¹⁰¹ The court expressly refused to follow the New Jersey case of *Henningsen v. Bloomfield Motors, Inc.*¹⁰² which held that any disclaimer of liability for personal injury was contrary to public policy.

These express warranties of performance have also become interwoven with the buyer's right to revoke his acceptance during the warranty period and the dealer's right to "cure" when confronted with this revocation. In *Rozmus v. Thompson's Lincoln-Mercury, Co.*¹⁰³ the buyer heard a "banging and thumping sound" upon his driving of a new car from the dealer's showroom. The buyer immediately communicated with the dealer who attempted to correct the condition. The repair was unsuccessful, and the buyer brought the car back to the dealer. The car was put on the car rack, but before the mechanic could make the repair (which was a minor one) the buyer demanded either another new car as a substitute or the return of his trade-in automobile. The dealer refused, and the buyer abandoned the car at the dealer's premises where it was later repossessed by the finance company. The court held that the buyer had accepted the automobile under section 2-606 and that he could not revoke his acceptance unless he was able to show that the non-conformity of the automobile substantially impaired its value to him. The court seemed to say that

100. U.C.C. § 2-719(3).

101. *Marshall v. Murray Oldsmobile Co., Inc.*, 154 S.E.2d 172 (Va. 1967).

102. 32 N.J. 358, 161 A.2d 69 (1959).

103. 209 Pa. Super. 120 (1966).

there would not be a substantial impairment when relatively minor repairs could be made to the goods.

A somewhat similar view upholding the dealer's right to cure by making minor repairs was advanced by the Court of Appeals for the District of Columbia.¹⁰⁴ A consumer claimed that his color television set did not function properly. The sales ticket guaranteed ninety days' free service and replacement of tubes and parts for one year. He denied the merchant-dealer any opportunity to inspect the unit in order to determine whether minor repairs or adjustment would cure the defect, or to replace the set if the defect could not be cured. The buyer insisted on a replacement set, and when the dealer refused in the absence of being given an opportunity to inspect it, the buyer attempted to revoke. The court held in favor of the dealer on the grounds that the buyer never gave the dealer an adequate opportunity to make a determination of repair or replacement. The court was really holding that the buyer has a good faith duty to allow the merchant access to the goods in order that he might make relatively minor repairs under section 2-508. These cases should be contrasted with *Zabriskie Chevrolet, Inc. v. Smith*,¹⁰⁵ in which the automobile stalled because of a defective transmission minutes after leaving the dealer. The court was of the view that there was no acceptance by the mere fact of taking delivery of the car and driving less than a mile before the defect appeared. The dealer offered to replace the defective transmission by taking one "of unknown lineage" from another automobile in its showroom and installing it in the buyer's car. The court held that this was not a sufficient offer to cure under 2-508, but it would appear that the court might have ruled in favor of the dealer if it had offered to replace the defective transmission with a new factory delivered transmission of "known lineage."

Transmission trouble also plagued the buyer in *Sarnecki v. Al Johns Pontiac*.¹⁰⁶ The testimony showed that the transmission was defective and that the dealer unsuccessfully attempted on a number of occasions to repair it. After the car had been driven 3,300 miles by the consumer and the dealer in testing the car after the several repair attempts, the buyer sought to rescind on the ground that he had requested the installation of a new transmission after it appeared that the dealer was unable to repair the original one. The court held that the dealer had breached an implied warranty of merchantability which was ineffectively disclaimed under the then standard automobile warranty and disclaimer clause because it was not so conspicuous as to exclude the implied warranty of merchantability.

In perhaps rare instances the manufacturer's express warranty may subject it to liability based upon fraud. One complaint alleged that an automobile manufacturer manufactured cars with an "especially sensitive

104. *Wilson v. Scampoli*, 228 A.2d 848 (D.C. Ct. App. 1967).

105. 99 N.J. Super. 441, 240 A.2d 195 (1968).

106. 56 Luz. Leg. Reg. Repts. 393, 3 U.C.C. Rept. Serv. 1121 (C.P. Luzerne County 1966)

suspension system" causing extreme vibration and warranted that its dealers would remedy defects during the warranty period, knowing that its dealers could not remedy these defects but that they could be corrected only in the factory. The South Carolina Supreme Court held that the complaint stated a cause of action for fraud on the basis that the warranty was issued without any intention to perform.¹⁰⁷

D. *Implied Warranties*

1. MERCHANTABILITY

When the seller "is a merchant with respect to goods of that kind" the Code imposes a warranty that the goods are merchantable unless that warranty is properly disclaimed or modified.¹⁰⁸ The Code articulates six non-exclusive minimum criteria for determining merchantability,¹⁰⁹ the most important for the consumer being that the goods "are fit for the ordinary purposes for which such goods are used."¹¹⁰ Under this standard, an air-conditioner that would not cool or a refrigerator which would not refrigerate at a temperature which may be standard in the industry would not meet this definition of merchantability.¹¹¹

2. FITNESS FOR A PARTICULAR PURPOSE

The warranty of merchantability is often defined as a warranty of "ordinary use," while a warranty of fitness for a particular purpose "envisages a specific use by the buyer which is peculiar to the nature of his business."¹¹² This latter warranty arises when the seller knows or has reason to know that the buyer is buying the goods for a particular purpose and that the buyer is relying upon the seller's supposed skill or judgment to furnish goods for this purpose. For example, if John Consumer should inform the salesman for Merchants Appliance Company that he desires to purchase an air-conditioner to cool a room containing a specified number of cubic feet and the salesman suggests a certain kind and model air-conditioner which John buys, the warranty for a particular purpose arises. Conversely, if John fails to inform Merchants of his par-

107. *Willard v. Chrysler Corp.*, 248 S.C. 42, 148 S.E.2d 867 (1966).

108. U.C.C. § 2-314.

109 U.C.C. § 2-314(2):

- (2) Goods to be merchantable must be at least such as
- (a) pass without objection in the trade under the contract description; and
 - (b) in the case of fungible goods, are of fair average quality within the description; and
 - (c) are fit for the ordinary purposes for which such goods are used; and
 - (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit among all units involved; and
 - (e) are adequately contained, packaged, and labeled as the agreement may require; and
 - (f) conform to the promises or affirmations of fact made on the container or label if any.

110. U.C.C. § 2-314(2) (c).

111. U.C.C. § 2-314, Comment 2.

112. U.C.C. § 2-315, Comment 2.

ticular needs, then a warranty of merchantability would be imposed but a warranty for a particular purpose might not be. The hypothetical problem states that John informs Merchants Appliance of his needs. There need not be an overt communication if John is able to show that Merchants had "reason to know" of his requirements. For example, if Merchants had sold air-conditioners to John's neighbors in the same project development, a case could be made that Merchants had reason to know. Insofar as the refrigerator is concerned, if John should inform the salesman that he wanted a refrigerator which would keep meats frozen for so many days, then Merchants would incur this warranty duty if they recommended a certain brand and model and John relied upon this advice.

Prior to the Code, if John should insist upon a certain trade name brand of air-conditioner there could not be a warranty for a particular purpose because John's insistence would show that there was no reliance on Merchants Appliance Company. This logical rule was extended somewhat illogically to cases where John might go to a dealer who dealt solely in goods made by one manufacturer, the purchase of patent or trade name items from a dealer who sold only one line being deemed sufficient to show that John did not rely.¹¹³ The Code has perpetuated part of the rule; if John *insists* upon a particular brand then he is not relying upon the dealer. However, the mere fact that John purchases a trade name item from a dealer who deals solely in that trade name item (or from a dealer who deals in many different trade name items) will not be sufficient in itself to show that John did not rely upon the supposed expertise of the dealer who has recommended one particular model based upon John's expressed or implied needs. The trade name purchase is only one facet of reliance to be considered by the trier of fact.¹¹⁴

3. CUMULATIVE EFFECT OF AND CONFLICT BETWEEN WARRANTIES

The Code succinctly states,¹¹⁵

Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable the intention of the parties shall determine which warranty is dominant. In ascertaining that intention the following rules apply:

- (a) Exact or technical specifications displace an inconsistent sample or model or general language of description.
- (b) A sample from an existing bulk displaces inconsistent general language of description.
- (c) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

113. UNIFORM SALES ACT § 15(4). See L. VOLD, SALES 437-443 (2d ed. 1951).

114. U.C.C. § 2-315, Comment 5.

115. U.C.C. § 2-317.

The Comment to this section expressly engrafts the good faith limitation on the use of this apparently mechanical test of determining intention, stating,¹¹⁶

These rules of intention are to be applied only where factors making for an equitable estoppel of the seller do not exist and where he has in perfect good faith made warranties which later turn out to be inconsistent. To the extent that the seller has led the buyer to believe that all of the warranties can be performed, he is estopped from setting up any essential inconsistency as a defense.

The Comment further expresses the view that "these rules are not absolute" and that a court may refuse to use the Code tests if it would result in an inconsistent or unreasonable construction of the agreement.¹¹⁷

In our original hypothetical problem, Merchants Appliance Company has made affirmations of fact to John Consumer to the effect that the air-conditioner will cool so many cubic feet at so many degrees and that Merchants will repair all defects within one year after installation. The air-conditioner is delivered and installed, and John receives a copy of the factory warranty (which is adopted by Merchants). This warranty provides for repair for only the first ninety days and states that this unit is not proper for the size of the room in which it was installed. A court should hold that the express factory warranty which negates the use of this unit in John's bedroom does not negate the dealer's implied warranty of fitness for a particular purpose which was created by express affirmation. It is to be noted that an express affirmation of fact will not only constitute an express warranty, but it can also be treated as a part of the basis of the bargain, creating an implied warranty of fitness for a particular purpose which will survive an inconsistent express warranty.¹¹⁸ Insofar as the inconsistency between the "service periods" stated in the factory warranty (adopted by the dealer) and the dealer's oral affirmation or promise is concerned, it would seem that Merchants has led John to believe that the unit had a one-year service period and should be estopped from claiming the shorter period under the written warranty. This is particularly true in the ordinary case in which the consumer never sees the written warranty until the unit is delivered and installed in his house.

4. DISCLAIMERS OF IMPLIED WARRANTIES OF QUALITY AND DAMAGES

The disclaimer and modification of warranty sections of the Code were seemingly designed to forbid sellers from creating traps for unwary buyers. In certain cases they have been construed as a trap for sellers who do not carefully track the provisions.

A written agreement which attempts to disclaim or modify the

116. U.C.C. § 2-317, Comment 2.

117. U.C.C. § 2-317, Comment 3.

118. U.C.C. § 2-317(c).

implied warranty of merchantability must mention the word "merchantability" and the exclusion or modifying language must be conspicuous.¹¹⁹ The question of whether a term or clause is conspicuous is a question to be decided by the judge, not by the jury.¹²⁰ The two tests of "conspicuousness" are whether the term or clause is "so written that a reasonable person against whom it is to operate ought to have noticed it" and whether the wording contained in the body of the agreement is printed "in larger or other contrasting type or color."¹²¹ The Comments note that the "test is whether attention can reasonably be expected to be called to it."¹²² This Comment was of controlling importance in the case of *Hunt v. Perkins Machinery Co., Inc.*¹²³ The seller's printed purchase order forms were printed in pad form with the copies separated by carbon paper, and the buyer did not receive a copy of the form until after he signed it. The face of the form stated that the "Order and Its Acceptance are Subject to 'Terms and Conditions' Stated in This Order,"¹²⁴ and these words were in boldface conspicuous type. The rear of the form contained a disclaimer in conspicuous language which disclaimed the implied warranties of merchantability and fitness for a particular purpose. The court stated that if the disclaiming language had appeared on the face of the form it would have met the Code's test. However, the attention of the buyer was not called to the reverse side of the form, and therefore the disclaimer was not "conspicuous" within the meaning of the Comment quoted above.

The warranty of fitness for a particular purpose may be excluded in writing which is conspicuous. A clause to the effect that "there are no warranties which extend beyond the description on the face hereof" is sufficient to exclude the warranty of fitness.¹²⁵ The Virginia Supreme Court of Appeals in *Marshall v. Murray Oldsmobile Co., Inc.*¹²⁶ was confronted with a pre-Code transaction in which a new car warranty furnished by the manufacturer provided that it was "in lieu of all other warranties."¹²⁷ The court held that under pre-Code law the quoted language was sufficient to exclude an alleged warranty of fitness for a particular purpose and that this rule was continued under the Code. The court's statement about the effect of section 2-316 of the Code was dicta; however, this dicta refused to follow the dicta in *Henningsen v. Bloomfield Motors, Inc.*,¹²⁸ in which the New Jersey Supreme Court stated that the standard automobile warranty which purportedly attempted to disclaim all implied warranties would not be given effect because it was deemed unconscionable. The Virginia court felt that if section 2-316

119. U.C.C. § 2-316(2).

120. U.C.C. § 1-201(10).

121. *Id.*

122. U.C.C. § 1-201, Comment 10.

123. 352 Mass. 535, 226 N.E.2d 228 (1967).

124. *Id.* at 536-37, 226 N.E.2d at 229.

125. U.C.C. § 2-316(2).

126. 207 Va. 972, 154 S.E.2d 140 (1967).

127. 207 Va. 972, 973, 154 S.E.2d 140, 141 (1967).

128. 32 N.J. 358, 161 A.2d 69 (1959).

allows a disclaimer, then it is a fallacy to say that the disclaimer is unconscionable. There is a superficially appealing logic in the Virginia view if section 2-316 is approached in a factual vacuum. However, considering that the standard car warranty is a contract of adhesion in which the consumer buyer has no power to bargain for any of its terms, that all car manufacturers use similar language to exclude implied warranties and that the average car buyer does not even receive the warranty until days after he takes possession of the car, then should not this disclaimer in conjunction with the total factual pattern be deemed unconscionable in accordance with the New Jersey view?

The rather clear effect of the above rules is seriously limited by the following rule:¹²⁹

Unless the circumstances indicate otherwise, all implied warranties are excluded by expression like "as is," "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty.

It is interesting to observe that a Comment requires the above exclusionary language to be in conspicuous print,¹³⁰ but the Code itself fails to require it. A Comment notes that this language is a common factual situation "in which the circumstances surrounding the transaction are in themselves sufficient to call the buyer's attention to the fact that no implied warranties are made or that a certain implied warranty is being excluded."¹³¹ It is suggested that the "as is" or "with all faults" language is usually present in the sale of second-hand goods rather than in the sale of new consumer goods; hence it should be of little concern to the average consumer. A consumer buyer of second-hand goods will be deprived of any economic protection as a result of his dealer's use of this language, but if personal injury results from a defect in the goods which was known to the seller he may well be liable under a deceit or negligence theory.¹³²

The consumer buyer may also be denied any implied warranty protection in the event that he examines the goods before entering into the contract (or refuses to examine them) "with regard to defects which an examination ought in the circumstances to have revealed to him."¹³³ Latent defects are, by their nature, of a kind which would not be apparent in the ordinary examination and will not be excluded under this rule.¹³⁴

129. U.C.C. § 2-316(3)(a).

130. U.C.C. § 2-316, Comment 4. Compare the wording of subsections 2 and 3 of § 2-316 as to the question of conspicuous print; subsection 3 applies "notwithstanding subsection (2)."

131. U.C.C. § 2-316, Comment 6.

132. *E.g.*, *Fleming v. Stoddard Wendle Motor Co.*, 35 L.W. 2525 (Wash. 1967); *see also* U.C.C. § 2-314, Comment 3. There may be a warranty of merchantability in Florida when second hand goods are sold by a dealer in these goods. *Enix v. Diamond T. Sales & Service Co.*, 188 So.2d 48 (Fla. 2d Dist. 1966).

133. U.C.C. § 2-316(3)(b).

134. U.C.C. § 2-316, Comment 8.

Further, a consumer will be held to the knowledge of a consumer and "will be held to have assumed the risk only for such defects as a layman might be expected to observe."¹³⁵ In order for the seller to claim that the buyer refused to examine the goods, the goods not only have to be available for inspection but the dealer must "demand" that the buyer examine them.¹³⁶ Let us assume that John Consumer examines an air-conditioner and refrigerator before he agrees to buy them pursuant to Merchant's demand, and that during the course of his examination he raises certain objections or asks certain questions. Merchants Appliance Company will most likely make statements to overcome these objections or to answer these questions. If John indicates clearly that he is relying on these statements rather than on his examination, these statements will give rise to express warranties including an express warranty of merchantability.¹³⁷ In this latter case, Merchants Appliance Company may give more warranties than it intended to do when it "demanded" that John examine the goods.

In addition to or in lieu of disclaiming warranties, the dealer may provide in his sales contract for a liquidation of damages, a limitation on their amount, a contractual modification of the remedy, or a combination of all three.¹³⁸

The Code's articulation of the liquidated damage concept, as follows, seems to be of doubtful utility in the consumer breach of warranty area:

Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. *A term fixing unreasonably large liquidated damages is void as a penalty.*¹³⁹

If one refers to the italicized words above, there would seem little likelihood of a seller's fixing "unreasonably large liquidated damages" in the typical seller's form sales contract. However, if the seller should fix an unreasonably small amount as liquidated damage it may be stricken on the grounds of unconscionability.¹⁴⁰ The liquidated damage rules of section 2-718 seem designed for merchants' sales to other merchants rather than to consumers.

Of much greater utility in the consumer area is the rule that the parties may provide for remedies in addition to or in substitution for those provided for in article 2 and may limit or alter the amount of damages, as by "limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of the non-

135. *Id.*

136. *Id.*

137. *Id.*

138. U.C.C. § 2-316(4).

139. U.C.C. § 2-718(1) (emphasis added).

140. U.C.C. § 2-718, Comment 1.

conforming goods or parts.”¹⁴¹ The seller must expressly state in the sales contract that any contractual modification of the buyer’s remedies is “exclusive;” otherwise the buyer has the option to resort to the contractual remedy or the remedies given by the Code or both.¹⁴² Let us assume that Merchants Appliance Company has sold a refrigerator to John Consumer. The form sales contract provides that Merchants agrees to “repair and replace defective parts in the unit at its expense for a period of ninety days and that the parties agree that Merchants Appliance Company will not be liable for damages for loss of use of the unit, for loss of food as a result of failure of the compressing unit and for personal injuries or death resulting from defects in the refrigerator, and that the buyer’s remedies are exclusively as described in this contract.” There seems little question that courts should uphold this clause as barring the buyer from recovering for loss of use of the refrigerator and for loss of food through spoilage on the ground that the seller has properly limited his liability for consequential damages.¹⁴³ A court can, however, deem that this limitation of consequential damages for economic loss is unconscionable upon consideration of the totality of the factual pattern of the transaction.

Assuming that a short circuit in the refrigerator caused injury or death of John Consumer or members of his household,¹⁴⁴ the Code provides that limitations of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable,¹⁴⁵ and courts should have little difficulty in invalidating these clauses. However, if Merchants Appliance Company should couple this limitation on consequential damage clause with a proper disclaimer of warranty clause,¹⁴⁶ then it may escape liability entirely unless the court follows *Henningsen*¹⁴⁷ and invalidates the disclaimer on the grounds of unconscionability or ignores the Code entirely and proceeds under section 402A of the *Restatement of Torts*.¹⁴⁸

The damage discussion under the express warranty of title section of this article is applicable to breach of warranties of quality when there is no contractual limitation of damages.¹⁴⁹

E. *Rejection, Acceptance and Revocation of Acceptance for Breach of Warranty*

In the ordinary retail sale of appliances or other large, bulky items from showroom display models, the buyer will not receive the identical

141. U.C.C. § 2-719(1) (a).

142. U.C.C. § 2-719(1) (b).

143. U.C.C. § 2-719(3).

144. U.C.C. § 2-318.

145. U.C.C. § 2-719(3).

146. U.C.C. § 2-719, Comment 3.

147. 32 N.J. 358, 161 A.2d 69 (1959).

148. See R. DUESENBERG & L. KING, *SALES AND BULK TRANSFERS* § 7.06 (1966); Note, *Economic Loss in Products Liability Jurisprudence*, 66 COLUM. L. REV. 917 (1966).

149. See page 25 *supra*.

appliance which he examined prior to making the purchase; the purchased goods will be withdrawn from stock and will be (hopefully) the same as the examined model. Sometime after the purchase is made, the appliances will be delivered to the buyer, and, at that time, he has the following three alternatives open to him regarding any breach of warranty: he may reject, accept under protest, or revoke his acceptance.

1. REJECTION

If we assume that a tender of delivery is made of the air-conditioner and refrigerator in our hypothetical problem, John Consumer may reject the goods if the defect is an obvious one which he discerns upon tender. However, even after the goods have been delivered he has a reasonable time in which to ascertain that there is a defect and to notify the seller of this fact.¹⁵⁰ John Consumer must take affirmative action to avoid being held to have accepted the goods.¹⁵¹ After John has notified Merchants Appliance Company of the defect within a reasonable time, John may not use the appliances because this may be considered as an exercise of ownership and wrongful as to the seller.¹⁵² If John has not paid any part of the purchase price (an unlikely event except in the case of department store charge accounts), he must hold them with reasonable care for a sufficient time to give the seller an opportunity to remove them.¹⁵³ If John has paid part or all of the purchase price of the defective goods, he has a security interest in the goods for the amount paid plus expenses incurred in their inspection, receipt, transportation, care and custody, and he may hold the goods and then sell them.¹⁵⁴

John Consumer's right to reject will be limited in some cases by the right of Merchants Appliance Company to "cure" the defect. This cure concept (which will be discussed in a subsequent sub-section¹⁵⁵) is the underlying basis for the rule that the buyer who rejects because of a "particular defect which is ascertainable by reasonable inspection"¹⁵⁶ must state this defect to the seller. Buyers are precluded from relying upon unstated defects to justify rejection and from relying upon them as a breach of the contract of sale in any case where the seller could have cured the defects had he been seasonably notified of them. The consumer buyer may give a quick and informal notice of defects at the time of tender which does not mislead the seller.¹⁵⁷ A buyer who rejects without articulating his objections is "probably acting in commercial bad faith and seeking to get out of a deal which has become unprofitable."¹⁵⁸ It is

150. U.C.C. § 2-601(1).

151. U.C.C. § 2-601, Comment 1.

152. U.C.C. § 2-602(2)(a).

153. U.C.C. § 2-602(2)(b).

154. U.C.C. §§ 2-602(b) and 2-711(3).

155. See page 41 *infra*.

156. U.C.C. § 2-605(1).

157. U.C.C. § 2-605, Comment 1.

158. U.C.C. § 2-605, Comment 2.

believed that this rule should not cause hardships to consumers because it reflects the fact that most dissatisfied consumers will express their dissatisfaction with their purchases in a most specific way.

2. ACCEPTANCE AND ITS EFFECTS

The right to reject a non-conforming tender and the notion of acceptance are linked together because a buyer who fails to reject within a reasonable time after he has had an opportunity to inspect them will be deemed to have accepted the goods.¹⁵⁹ As a result, consumers should be cautioned to make an examination of the goods as soon as possible after they have received the goods; any unexcused slumbering on their rights may prove costly. In a similar vein, if the buyer signifies to the seller that the goods are conforming or that he will keep them in spite of their non-conformity, these verbal acts will also constitute an acceptance.¹⁶⁰ Although it is not required by the Code,¹⁶¹ it is suggested that a buyer who is willing to accept in spite of the non-conformity of the goods should notify the seller in writing that the acceptance is to be considered without prejudice to the buyer's right to sue for damages and without prejudice to the seller's duty to cure the defects. This suggestion is based upon the idea of building a record for any possible litigation which may result.¹⁶² Finally, if the consumer buyer does "any act inconsistent with the seller's ownership" it may constitute an acceptance only if ratified by the seller.¹⁶³ It would seem that a consumer buyer's use of defective consumer goods could constitute an act inconsistent with the seller's ownership rights and be deemed an acceptance. Of more importance, perhaps, is the fact that if the use of the defective goods resulted in property loss (*e.g.*, spoilage of frozen foods in a refrigerator which was used in spite of a defective cooling mechanism) or in personal injury (*e.g.*, a short circuit in the wiring which caused electrocution of a user) the seller could avoid liability under the theory that consumer user could have avoided the harm by not using the defective goods.¹⁶⁴

The buyer may not reject goods after he has accepted them nor may he revoke his acceptance if he accepted the goods with knowledge of the non-conformity unless his acceptance was "on the reasonable assumption that the non-conformity would be seasonably cured."¹⁶⁵ The buyer must pay the sales price for accepted goods; however, the acceptance does not impair the buyer's rights to damages for defects if the buyer notifies the seller of the defects within a reasonable time after he discovers or should have discovered them. Insofar as consumers are concerned, a

159. U.C.C. § 2-606(1)(b).

160. U.C.C. § 2-606(1)(a).

161. U.C.C. § 2-601 and Comments; U.C.C. § 1-207, Comment 2.

162. *See* U.C.C. § 1-207.

163. U.C.C. § 2-606(1)(c).

164. U.C.C. § 2-316, Comment 8.

165. U.C.C. § 2-607(2).

reasonable time for notification is designed to defeat commercial bad faith and not to deprive a consumer of his remedy. Hence a consumer buyer will have a longer period of time in which to notify the seller than will a merchant buyer.¹⁶⁶ The Comments draw an important distinction between the degree of specificity required in the "rejection" notice given to the seller and the notice required under the acceptance concept.¹⁶⁷ It is enough for the buyer to inform the seller that "the transaction is still troublesome," and he need not claim damages or threaten litigation. It is designed to open the way for settlement through negotiation which would include cure by the seller, reduction of the purchase price, etc.¹⁶⁸

The Code states that the burden of proof is on the buyer to establish any breach in regard to accepted goods.¹⁶⁹ However, the Comments explain that this "burden of proof" is purely a procedural matter allowing the buyer to file a counter-claim for damages when sued for the price or to sue for "recoupment in diminution or extinction of the price."¹⁷⁰

3. REVOCATION OF ACCEPTANCE

The Code has introduced a new concept of revocation of acceptance in place of the former theory of rescission (with its varying meanings) and has added the rule that the buyer may revoke and also claim damages. He need not elect between these two remedies.¹⁷¹ In general, the buyer may revoke his acceptance when the known non-conformity of the goods substantially impairs its value to him, and when he reasonably assumed that the non-conformity would be seasonably cured but it has not been. In the event that he accepted the goods without knowledge of the non-conformity, "if his acceptance was reasonably induced either by the difficulty of discovery before acceptance *or by the seller's assurances*" he may also revoke.¹⁷² The ambiguous italicized words are explained as meaning language used in the contract, explicit language used at the time of delivery, or in the "circumstances" of the case, which induce the buyer in delaying discovery of the defects.¹⁷³

In accord with the rejection and acceptance rules, the buyer must revoke his acceptance within a reasonable time after he discovers or should have discovered the non-conformity and "before any substantial change in condition of the goods which is not caused by their own defects."¹⁷⁴ The quoted words should have little importance in the average consumer goods purchase of non-perishable commodities. The revocation is not effective until the buyer notifies the seller. The "reasonable" time

166. U.C.C. § 2-607, Comment 4.

167. U.C.C. § 2-607, Comment 4.

168. *Id.*

169. U.C.C. § 2-607(4).

170. U.C.C. § 2-607, Comment 6.

171. U.C.C. § 2-608, Comment 1.

172. U.C.C. § 2-608(1)(b).

173. U.C.C. § 2-608, Comment 3.

174. U.C.C. § 2-608(2).

limitation in this revocation rule will ordinarily start running only after the buyer has attempted adjustment with the seller who has refused or failed to cure or reduce the price.¹⁷⁵ An underlying policy dictates that the buyer ought to give the seller notice as quickly as possible in order for the seller to make adjustments. Hence a good faith consumer buyer who attempts to revoke his acceptance but fails to itemize specifically all of the defects may not be bound by his original revocation which does not mislead the seller and prevent him from making a reasonable adjustment.¹⁷⁶

A buyer who revokes his acceptance rather than rejecting upon tender of delivery is not penalized for his forbearance. He has the same rights and duties as if he had rejected the goods.¹⁷⁷

4. THE SELLER'S RIGHT TO CURE AND THE BUYER'S RIGHT TO ADEQUATE ASSURANCE

One consistent thread runs throughout the Code sections dealing with rejection, acceptance and revocation of acceptance: the buyer's right to utilize these steps is conditioned upon the seller's right to "cure" the defects. These reciprocal rights and duties are so well coordinated that they should result in satisfactory adjustment of quality disputes without litigation. This is particularly important in the consumer area where the amounts involved often make litigation impractical.

The Code carefully distinguishes between the seller's right to cure before the contract period of delivery and after this period. In the former case, when the time for performance has not elapsed and the buyer rejects the goods because of non-conformity, the seller may notify the buyer that he intends to cure. The seller must then make a conforming delivery within this contract period. The seller has this right of cure even when he has picked up the goods and refunded the purchase price; he can still make another tender of conforming goods within the period of the contract.¹⁷⁸ It is doubted that this right of cure will have much practical utility in the sale of consumer goods. John Consumer's contract of sale with Merchants Appliance will usually have no specific date of tender; in fact, the date of tender is ordinarily set by the tender itself.

However, the Code also provides that when the buyer rejects a non-conforming tender "*which the seller had reasonable grounds to believe would be acceptable,*" the seller then has a further reasonable time to substitute a conforming tender if he seasonably notifies the buyer of his intention to do so.¹⁷⁹ The italicized words may be troublesome to apply. For example, assume that Merchants Appliance Company delivers an air-conditioner and a refrigerator to John Consumer. John uses these

175. U.C.C. § 2-608, Comment 4.

176. U.C.C. § 2-608, Comment 5.

177. U.C.C. § 2-608(3).

178. U.C.C. § 2-508(1) and Comment 1.

179. U.C.C. § 2-508(2) (emphasis added).

units for a few days, and both of them prove to be defective. Merchants Appliance sold these appliances in good faith and without knowledge of the defects—does this constitute reasonable grounds to believe that the goods would be acceptable? The Comments state that reasonable grounds to believe can be found in the prior course of dealing between the parties (if any), a course of performance between the parties (*e.g.*, these two appliances were one installment of a number of appliances purchased under one contract from Merchants, defects had appeared in the other appliances and cure was made), or usage of the trade, “as well as in the particular circumstances surrounding the making of the contract.”¹⁸⁰

If we assume that there have not been any prior dealings between the parties or course of performance between them, we are then faced with the “usage of the trade” concept. The Code defines a usage of trade as¹⁸¹

any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts.

It is to be observed that a trade usage does not have to be of ancient or immemorial origin. On the contrary, “full recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree.”¹⁸² Under this standard, Merchants can prove that the majority of “decent dealers” in the place of the sale “stand behind” the sale of their trade name appliances. Further, the usage in the appliance trade could be for dealers to make an inspection of their appliances when they are uncrated upon delivery from their suppliers, and based upon his inspection and prior experience with this make of air-conditioner and refrigerator the merchant had reasonable grounds to believe that they would be acceptable to the buyer.

It is true that a court which is hostile to this notion of cure may construe the words “reasonable grounds to believe” as being limited to cases where the seller *knows* that his tender does not conform exactly with the terms of the contract but believes in good faith that the substitute goods are as good as or better than those called for by the contract. This latter interpretation would deprive this healthy cure rule of all effect. On the other hand, a sympathetic application of the cure rule will protect the good faith buyer (who is not stubbornly insisting upon his rights to revoke his acceptance and to sue for damages) and will protect the good faith seller who is trying to give the buyer the benefit of his bargain. A classic illustration of the full use of this principle occurred in a recent

180. U.C.C. § 2-508, Comment 2.

181. U.C.C. § 1-205(2).

182. U.C.C. § 1-205, Comment 5.

case involving the sale of a hearing aid.¹⁸³ A buyer sought to purchase a certain model hearing aid which had been recommended to him. However, the dealer sold an improved but modified version of the desired hearing aid. The buyer was not satisfied and returned it upon discovering that he had not received the model he had requested. The dealer and the manufacturer explained the facts to the buyer and stated that they were willing to supply the model originally requested by him, but the buyer refused and demanded the return of his money. The court held that the time for performance had expired, but that the seller had reasonable cause to believe that the new model would be satisfactory to the buyer who was not entitled to reject under section 2-601 of the Code.

This cure rule presents another problem of interpretation. The section speaks of the buyer's rejecting a non-conforming tender—does this confine the cure to the rejection stage, or may it also be applied in the event that the buyer revokes his acceptance? If a court looks at this section with tunnel vision, it cannot be applied upon revocation of acceptance. However, as previously stated, a buyer who properly revokes his acceptance "has the same rights and duties with regard to the goods involved as if he had rejected them,"¹⁸⁴ and this would logically give the seller the right to cure.

Again, if we approach the cure rule with tunnel vision we would say that the seller's right to cure is (unless covered under a warranty or guaranty for repair for a performance period) limited to replacement of defective goods rather than repair. The wording and respective Comments of section 2-508 and sections 2-601 to 2-608 fail to hint that the notion of cure includes the idea of repair. Fortunately, a Comment to section 2-510 recognizes that cure may consist of repossession of the tendered goods and a new tender and also "changes in goods already tendered, such as repair, partial substitution, sorting out from an improper mixture and the like."¹⁸⁵ Admittedly section 2-510 is directed to the question of who bears the risk of loss to the goods when there is a breach (the "risk of their loss remains on the seller until cure or acceptance") rather than to the basic right to cure. This view that repair is encompassed within the idea of cure is further developed in a Comment to section 2-609 which deals with insecurity and adequate assurance, "where a delivery has defects, even though easily curable, which interfere with easy use by the buyer, no verbal assurance can be deemed adequate which is not accompanied by replacement, repair, money-allowance or other commercially reasonable cure."¹⁸⁶ It would be illogical to construe the right to cure as having one meaning in the "cure" section and a different meaning in other sections of the Code. Further, it would be

183. *Bartus v. Riccardi*, 55 Misc. 2d 3, 284 N.Y.S.2d 222 (Utica City Ct. 1967); 4 U.C.C. Reporting Service 845.

184. U.C.C. § 2-608(3).

185. U.C.C. § 2-510, Comment 2.

186. U.C.C. § 2-609, Comment 4.

even more illogical to assume that the draftsmen of the Code meant to confine cure to replacement of the goods exclusive of repair, as this would ignore the long established commercial practice of repairing (including replacement of parts) rather than complete replacement of the unit.

As previously indicated in the cure rules relative to a breach of warranty of title, the right of the seller to cure is coupled with the right of the buyer to demand adequate assurance that the seller will cure in a proper manner.¹⁸⁷ To apply this adequate assurance rule to our cure rule let us assume that John Consumer's air-conditioner and refrigerator have failed after a few days of use. John notifies Merchants Appliance Company that he has revoked his acceptance. Merchants then telephones John that it intends to repair the two appliances within the following week. If John has reservations about the worth of this oral promise, he may write to Merchants and demand adequate written assurance that it will perform within the following week. It is suggested that John specify in his written demand for adequate assurance that Merchants must reply within a set period (five days for example), otherwise it would appear that Merchants would have a "reasonable time not exceeding thirty days"¹⁸⁸ in which to give the written assurance, and this would exceed the time promised by Merchants to repair the appliance.

If John Consumer should hear reports from his friends and neighbors that Merchants Appliance has delivered defective goods to others and that Merchants' promises have not been performed, then John would have cause to demand more than mere written assurance and, in the exercise of good faith, he would be justified in demanding replacement rather than repair of the appliances.¹⁸⁹ In brief, the question of what is adequate must be determined by a consideration of the required good faith of the parties, commercial standards in the trade, solvency of the seller, etc.

In the event that Merchants Appliance Company should fail to provide adequate assurance within the period reasonably fixed by John in his written demand, this will constitute "a repudiation of the contract" by Merchants.¹⁹⁰ This repudiation involves the application of the Code's articulation of repudiation and the right of the repudiator to retract his repudiation. In the stated problem, John, upon failure to receive the adequate assurance, should inform Merchants by letter that he considers its repudiation as final¹⁹¹ and that he intends to bring suit for damages.¹⁹² Unless John takes these steps, Merchants may retract its repudiation unless John has "materially changed his position"¹⁹³ or has "cancelled" the contract.¹⁹⁴ Cancellation occurs when "either party puts an end to the con-

187. U.C.C. § 2-609.

188. U.C.C. § 2-609(4).

189. U.C.C. § 2-609, Comment 4.

190. U.C.C. § 2-609(4).

191. U.C.C. § 2-611(1).

192. U.C.C. § 2-610(b).

193. U.C.C. § 2-611(1).

194. U.C.C. §§ 2-610(1) and 2-106(4).

tract for breach by the other, and . . . the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance.”¹⁹⁵ There would seem to be no real difference between “cancelling” for a breach and considering that the seller’s repudiation is final in our hypothetical problem. The material change in position could occur if John should “cover” by purchasing an air-conditioner and refrigerator from another dealer, and the Code encourages buyers (both consumers and merchants) to cover.¹⁹⁶ Although it is not literally required, it is suggested that consumer buyers who have changed their position by “cover” should give repudiating sellers notice of this fact in order to reduce the possibility of litigation by sellers who may claim that they have retracted the repudiation and that the buyer has not changed his position in fact.

John Consumer has still another possibility open to him—he may “for a commercially reasonable time await performance” by Merchants, assuming that he may make do with his old air-conditioner and refrigerator until the matter is settled.¹⁹⁷ In this event, John should notify Merchants by letter that he expects it to retract its repudiation and to give adequate assurance that it will effectuate replacement or the necessary repairs to the appliances. Again, John should give Merchants a reasonable “deadline” for the retraction and the providing of adequate assurance, and, if these are not forthcoming, he can then proceed in accordance with the prior discussion.

VII. THE GOOD FAITH BUYER VIS A VIS THE TRUE OWNER, HOLDER OF A SECURITY INTEREST OR THE INTERNAL REVENUE SERVICE

Generations of property professors have waxed fond of the rights of an owner of goods to recover them or their value from a bona fide purchaser who purchased them from a vendor who had less than full title to the goods. The Code has changed much of this professional lore.

Let us assume that John Consumer has purchased a used stove from Ned Neighbor. Ned Neighbor purchased the stove recently from a merchant. Ned Neighbor paid for the stove with a check which was subsequently dishonored. Before the merchant could repossess the stove, John Consumer purchased it in good faith from Ned Neighbor. Under the Code, Ned Neighbor has voidable title but the transfer to John Consumer gives him good title and cuts off the interest of the merchant.¹⁹⁸ If Ned Neighbor should purchase the same stove by impersonating someone else and give a bad check in payment, or agree to pay for the stove later with title to remain in the merchant, John Consumer will still obtain good title by his bona fide purchase. Even though Ned Neighbor’s conduct could be

195. U.C.C. § 2-106(4).

196. U.C.C. §§ 2-711 and 2-712, Comment 4.

197. U.C.C. § 2-610(a).

198. U.C.C. § 2-403(1)(b) and (c).

classified as larcenous under the criminal law, he has the power to pass on good title to a bona fide purchaser.¹⁹⁹

The Code's protections of John Consumer extend further than just the casual buying of goods from a neighbor. If John Consumer should purchase a used television set from a dealer in new and used television sets, jewelry from a jeweler who sells used jewelry, furniture from a used furniture dealer, etc., he will obtain good title if he is a buyer in ordinary course of business even though these goods were entrusted to the merchant for storage or repair by the true owners.²⁰⁰ In order to be a buyer in the ordinary course of business, John Consumer must buy, in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods, from a "person in the business of selling goods of that kind."²⁰¹

The Code's protection to John Consumer extends into the purchase of used consumer goods which are subject to a security interest created by the non-merchant vendor. Assume that John Consumer purchases some household appliances from his neighbor, Ned Neighbor. Ned Neighbor purchased these appliances from Merchants Appliance Company under a purchase money security interest. Merchants Appliance Company did not file a financing statement²⁰² with the Clerk of the Circuit Court.²⁰³ The Code provides that purchase money security interests in consumer goods are perfected without filing a financing statement.²⁰⁴ However, if John Consumer purchased these household appliances without knowledge of Merchants Appliance Company's security interest and for his own personal, family or household purposes he will take free of this un-filed security interest.²⁰⁵ Of course, if Credit Appliance Company filed its financing statement, John Consumer will take subject to it.²⁰⁶

The Code has continued the protections articulated in the Uniform Trust Receipts Act²⁰⁷ which are designed to protect the buyer in the ordinary course of business from claims by inventory suppliers claiming a security interest. Assume that John Consumer purchased a refrigerator and air-conditioner for cash from Merchants Appliance Company. Merchants Appliance Company had purchased these goods from the manufacturer, and the sale was financed by Fabulous Factors which filed a financing statement evidencing a purchase money security agreement. This security agreement states that Merchants shall not sell these goods without the written permission of Fabulous Factors. John Consumer may purchase these appliances free from the security interest of Fabulous Fac-

199. U.C.C. § 2-403(1)(a), (b) and (d).

200. U.C.C. § 2-403(2) and (3).

201. U.C.C. § 1-201(9).

202. U.C.C. § 9-402.

203. U.C.C. § 9-401.

204. U.C.C. § 9-302(d).

205. U.C.C. § 9-307(2).

206. U.C.C. § 9-307(2).

207. UNIFORM TRUST RECEIPTS ACT § 9(2)(a) and (c).

tors even though he knows of the existence of this floor plan agreement, provided, however, that he does not know that the written permission of Fabulous Factors is needed for his purchase.²⁰⁸ John Consumer must be a buyer in ordinary course of business—he will be even if he knows of the existence of the security agreement but he will not be if he further knows that his purchase is in contravention of some provision contained in the security agreement.²⁰⁹

The consumer is concerned not only with the quality of the goods, claims of title of third persons and claims by security interest holders, but also with possible federal tax liens. The Federal Tax Lien Act of 1966²¹⁰ has created protections for the consumer in two separate areas. If John Consumer should purchase appliances from Merchants Appliance Company after a federal tax lien is filed against Merchants, John Consumer is protected by a "superpriority status" against the government provided that he had no knowledge of the filing of the lien.²¹¹ Prior to this legislation, the I.R.S. could have, at least in theory, levied on these goods in the hands of John Consumer.

This same act has given more limited protections to John if he should happen to buy a used refrigerator from his neighbor, Ned Neighbor. There are three qualifications to this protective rule: (a) John Consumer must not have actual knowledge of the existence of the tax lien; (b) the sales price must be *less* than two hundred fifty dollars; and (c) it must be a "casual" sale, *i.e.*, this particular sale must not be one sale in a series of sales.²¹² For example, if Ned Neighbor is merely selling one thing—the refrigerator—this would be a casual sale. However, if John Consumer knows that Ned Neighbor is selling all of his goods in a "series of sales," this would not qualify as a casual sale.

SECURITY INTERESTS

I. INTRODUCTION

Article 9 of the Code is intended to apply to any transaction regardless of its form which is intended to create a security interest in personal property or fixtures.²¹³ The article primarily articulates rules defining rights of a secured party against persons dealing with the debtor. It does not²¹⁴

208. U.C.C. § 9-307(1).

209. U.C.C. § 1-201(9).

210. INT. REV. CODE OF 1954, § 6323.

211. INT. REV. CODE OF 1954, § 6323(b)(3).

212. INT. REV. CODE OF 1954, § 6323(b)(4). For further discussion of the Tax Lien Act, see Coogan, *The Effect of the Federal Tax Lien Act of 1966 Upon Security Interests Created Under the Uniform Commercial Code*, 81 HARV. L. REV. 1369 (1968); Plumb, *The New Federal Tax Lien Law—Part I*, 13 PRAC. LAW 63 (1967); 4 C.C.H. 1966 STAND. FED. TAX REP. 54 (Dec. 21, 1966).

213. U.C.C. § 9-102(1)(a).

214. U.C.C. § 9-102(3) Note. See also §§ 9-201, 203(2) Note; 1-103, 104; 2-102.

prescribe regulations and controls which may be necessary to curb abuses arising in the small loan business or in the financing of consumer purchases on credit. Accordingly there is no intention to repeal existing regulatory acts in those fields.

Many states have legislated in the retail consumer credit area with varying degrees of success varying from the consumer loaded approach of Maryland²¹⁵ to the rather vacuous approach of Florida.²¹⁶ This diversity of approach was one of the reasons for the draftsmen of the Code to abstain from any thorough, pin-pointed regulation of consumer credit. This abstention has given rise to a demand for adoption of state truth-in-lending laws and other consumer oriented protective legislation.²¹⁷ Part of this demand has been met by the recent adoption of the Federal Consumer Credit Protection Act.²¹⁸

II. FEDERAL CONSUMER CREDIT PROTECTION ACT

The Federal Consumer Credit Protection Act of 1968 was enacted to enhance strengthened competition between financial institutions and other firms engaged in the extension of consumer credit by requiring a "meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various terms available to him and avoid the uninformed use of credit."²¹⁹ In order to accomplish these objectives, the Act requires that a creditor²²⁰ who extends consumer credit²²¹ under finance charges²²² shall disclose clearly and conspicuously certain required information to the consumer.²²³

The Act creates a triptych of consumer credit transactions and sets out specific rules for each.

215. *Stride v. Martin*, 184 Md. 446, 41 A.2d 489 (1945).

216. FLA. STAT. §§ 520.12 and 520.39 (1967).

217. See THE LAW AND THE LOW INCOME CONSUMER (C. Katz ed. 1968); Johnson, *Regulation of Finance Charges on Consumer Installment Credit*, 66 MICH. L. REV. (1967); Jordan and Warren, *The Uniform Consumer Credit Code*, 68 COLUM. L. REV. 387 (1968); Ziegel, *Consumer Credit Regulation: A Canadian Consumer-Oriented Viewpoint*, 68 COLUM. L. REV. 488 (1968). See also Ortioue, *Too Little, Too Late?*, 14 CATH. LAW. 153, 157 (1968).

218. Act of May 29, 1968, Pub. L. No. 90-312, § 5.

219. Act of May 29, 1968, Pub. L. No. 90-312, § 102.

220. Act of May 29, 1968, Pub. L. No. 90-312, § 103(f):

The term "creditor" refers only to creditors who regularly extend, or arrange for the extension of, credit for which payment of a finance charge is required, whether in connection with loans, sales of property or services, or otherwise. The provisions of this title apply to any such creditor, irrespective of his or its status as a natural person or any type of organization.

221. Act of May 29, 1968, Pub. L. No. 90-312, § 103(e) and (h):

(e) The term "credit" means the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment.

...

(h) The adjective "consumer," used with reference to a credit transaction, characterizes the transaction as one in which the party to whom credit is offered or extended is a natural person, and the money, property, or services which are the subject of the transaction are primarily for personal, family, household, or agricultural purposes.

222. Act of May 29, 1968, Pub. L. No. 90-312, § 106:

(a) Except as otherwise provided in this section, the amount of the finance

A. *Open End Consumer Credit Plans*

The open end credit plan is defined as a plan "prescribing the terms of credit transactions which may be made thereunder from time to time and under the terms of which a finance charge may be computed on the outstanding unpaid balance from time to time thereunder."²²⁴ This plan would seem to signify the "revolving budget plan" or "revolving charge

charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit, including any of the following types of charges which are applicable:

(1) Interest, time price differential, and any amount payable under a point, discount, or other system of additional charges.

(2) Service or carrying charge.

(3) Loan fee, finder's fee, or similar charge.

(4) Fee for an investigation or credit report.

(5) Premium or other charge for any guarantee or insurance protecting the creditor against the obligor's default or other credit loss.

(b) Charges or premiums for credit life, accident, or health insurance written in connection with any consumer credit transaction shall be included in the finance charge unless:

(1) the coverage of the debtor by the insurance is not a factor in the approval by the creditor of the extension of credit, and this fact is clearly disclosed in writing to the person applying for or obtaining the extension of credit; and

(2) in order to obtain the insurance in connection with extension of credit, the person to whom the credit is extended must give specific affirmative written indication of his desire to do so after written disclosure to him of the cost thereof.

(c) Charges or premiums for insurance, written in connection with any consumer credit transaction, against loss of or damage to property or against liability arising out of the ownership or use of property, shall be included in the finance charge unless a clear and specific statement in writing is furnished by the creditor to the person to whom the credit is extended, setting forth the cost of the insurance if obtained from or through the creditor, and stating that the person to whom the credit is extended may choose the person through which the insurance is to be obtained.

(d) If any of the following items is itemized and disclosed in accordance with the regulations of the Board in connection with any transaction, then the creditor need not include that item in the computation of the finance charge with respect to that transaction:

(1) Fees and charges prescribed by law which actually are or will be paid to public officials for determining the existence of or for perfecting or releasing or satisfying any security related to the credit transaction.

(2) The premium payable for any insurance in lieu of perfecting any security interest otherwise required by the creditor in connection with the transaction, if the premium does not exceed the fees and charges described in paragraph (1) which would otherwise be payable.

(3) Taxes.

(4) Any other type of charge which is not for credit and the exclusion of which from the finance charge is approved by the Board by regulation.

(e) The following items, when charged in connection with any extension of credit secured by an interest in real property, shall not be included in the computation of the finance charge with respect to that transaction:

(1) Fees or premiums for title examination, title insurance, or similar purposes.

(2) Fees for preparation of a deed, settlement statement, or other documents.

(3) Escrow for future payments of taxes and insurance.

(4) Fees for notarizing deeds and other documents.

(5) Appraisal fees.

(6) Credit reports.

223. Act of May 29, 1968, Pub. L. No. 90-312, § 121.

224. Act of May 29, 1968, Pub. L. No. 90-312, § 103(i).

account" so popular in department store circles. The creditor is obligated *before opening* an open end plan to disclose to the debtor the conditions under which a finance charge may be imposed and the time period, if any, within which the debtor may repay without a finance charge; the method of determining the balance upon which a finance charge will be imposed; the method of determining the amount of the finance charge with any minimum charge which may be imposed, and four additional informational statements.²²⁵

At the end of each billing cycle, the creditor must transmit to the debtor a statement, where applicable, of the outstanding balance at the beginning of the statement period; the amount and date of each extension of credit and a brief description of the goods or services purchased or furnished; the total credits to the account during the billing period; and the amount of any finance charge which was added to the account during the period, "itemized to show the amounts, if any, due to the application of percentage rates and the amount, if any, imposed as a minimum or fixed charge."²²⁶

B. Sales Not Under Open End Credit Plans

Special rules are established for consumer credit sales not under an open end credit plan. The consumer, as we have seen,²²⁷ is a natural per-

225. Act of May 29, 1968, Pub. L. No. 90-312, § 127(a)(4)-(7):

(4) Where one or more periodic rates may be used to compute the finance charge, each such rate, the range of balances to which it is applicable, and the corresponding nominal annual percentage rate determined by multiplying the periodic rate by the number of periods in a year.

(5) If the creditor so elects,

(A) the average effective annual percentage rate of return received from accounts under the plan for a representative period of time; or

(B) whenever circumstances are such that the computation of a rate under subparagraph (A) would not be feasible or practical, or would be misleading or meaningless, a projected rate of return to be received from accounts under the plan.

The Board shall prescribe regulations, consistent with commonly accepted standards for accounting or statistical procedures, to carry out the purpose of this paragraph.

(6) The conditions under which any other charges may be imposed, and the method by which they will be determined.

(7) The conditions under which the creditor may retain or acquire any security interest in any property to secure the payment of any credit extended under the plan, and a description of the interest or interests which may be so retained or acquired.

226. Act of May 29, 1968, Pub. L. No. 90-312, § 127(b):

(b) The creditor of any account under an open end consumed credit plan shall transmit to the obligor, for each billing cycle at the end of which there is an outstanding balance in that account or with respect to which a finance charge is imposed, a statement setting forth each of the following items to the extent applicable:

(1) The outstanding balance in the account at the beginning of the statement period.

(2) The amount and date of each extension of credit during the period, and, if a purchase was involved, a brief identification (unless previously furnished) of the goods or services purchased.

(3) The total amount credited to the account during the period.

(4) The amount of any finance charge added to the account during the period, itemized to show the amounts, if any, due to the application of percentage rates and the amount, if any, imposed as a minimum or fixed charge.

227. Act of May 29, 1968, Pub. L. No. 90-312, § 103(e) and (h). (See note 221 *supra*).

son to whom is extended money, property or services "primarily for personal, family, household, or agricultural purposes."²²⁸ The term "credit sale" includes both the ordinary sale and certain types of bailments or leases which give the bailee or lessee the option to acquire ownership.²²⁹ These two definitions are not too dissimilar from those provided in the U.C.C., although the "agricultural purposes" phrase is not found in the Code in conjunction with "consumer goods."²³⁰

The creditor in a credit sale which is not under an open end arrangement must disclose the cash price of the property or service purchase; the sum of any amounts credited as a down payment (including any trade-in); the difference between the down payment and the cash price; all other charges, individually itemized, which are "included in the amount of credit but which are not part of the finance charge;" and the total amount to be financed.²³¹ When the sale does not deal with the sale of a dwelling, the creditor must also disclose the finance charge "which may in whole or in part be designated as a time-price differential or any similar term. . . ."²³² The finance charge must be expressed as an annual percentage rate unless it does not exceed five dollars on an amount not in excess of \$75 or if it does not exceed \$7.50, but it is on an amount exceeding \$75.²³³

A creditor may not divide one consumer credit sale into two separate sales in order to avoid this disclosure requirement.²³⁴ The creditor must also disclose the number, amount and due dates or periods of payments scheduled, default, delinquency or similar charges payable for late payments, and a description of any security interest "held or to be retained or acquired" by the creditor with a clear identification of the property encumbered by the security interest.²³⁵

The above disclosure must, in general, be made before the credit is extended, although the disclosure may be made on the indebtedness contract itself.²³⁶ Additional rules are provided for telephone or postal solicitations²³⁷ and for a series of credit sales made to one debtor.²³⁸

228. Act of May 29, 1968, Pub. L. No. 90-312, § 102(h).

229. Act of May 29, 1968, Pub. L. No. 90-312, § 103(g).

(g) The term, "credit sale" with respect to which credit is extended or arranged by the seller. The term includes any contract in the form of a bailment or lease if the bailee or lessee contracts to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the property and services involved and it is agreed that the bailee or lessee will become, or for no other or a nominal consideration has the option to become, the owner of the property upon full compliance with his obligation under the contract.

230. Compare U.C.C. §§ 9-109(1) and (2), 9-102(2) and 1-201(37) with §§ 102(h) and 103(g) of the Act.

231. Act of May 29, 1968, Pub. L. No. 90-312, § 128(a)(1)-(5).

232. Act of May 29, 1968, Pub. L. No. 90-312, § 128(a).

233. Act of May 29, 1968, Pub. L. No. 90-312, § 128(a)(7).

234. *Id.*

235. Act of May 29, 1968, Pub. L. No. 90-312, § 128(a)(8)-(10).

236. Act of May 29, 1968, Pub. L. No. 90-312, § 128(b).

237. Act of May 29, 1968, Pub. L. No. 90-312, § 128(c).

238. Act of May 29, 1968, Pub. L. No. 90-312, § 128(d).

C. Consumer Loans

The act also provides disclosure rules for consumer loans which do not entail a consumer credit sale nor an open end consumer credit plan. These resemble the disclosure rules previously discussed.²³⁹

D. Rights of Rescission

In any consumer credit transaction wherein a security interest is retained or acquired in real property "which is used or is expected to be used as the residence of the person to whom the credit is extended," the debtor has the right to rescind the transaction before midnight of the third business day following the consummation of the transaction *or* the delivery of the disclosure required under the Act, whichever is later. The debtor must notify the creditor of his intention to rescind in accordance with regulations of the Board of Governors of the Federal Reserve System. The creditor must clearly and conspicuously disclose (in accordance with the Board's regulations) to any debtor that he has a right to

239. Act of May 29, 1968, Pub. L. No. 90-312, § 129:

Consumer loans not under open end credit plan

(a) Any creditor making a consumer loan or otherwise extending consumer credit in a transaction which is neither a consumer credit sale nor under an open end consumer credit plan shall disclose each of the following items, to the extent applicable:

(1) The amount of credit of which the obligor will have the actual use, or which is or will be paid to him or for his account or to another person on his behalf.

(2) All charges, individually itemized, which are included in the amount of credit extended but which are not part of the finance charge.

(3) The total amount to be financed (the sum of the amounts referred to in paragraph (1) plus the amounts referred to in paragraph (2)).

(4) Except in the case of a loan secured by a first lien on a dwelling and made to finance the purchase of that dwelling, the amount of the finance charge.

(5) The finance charge expressed as an annual percentage rate except in the case of a finance charge.

(A) which does not exceed \$5 and is applicable to an extension of consumer credit not exceeding \$75, or

(B) which does not exceed \$7.50 and is applicable to an extension of consumer credit exceeding \$75.

A creditor may not divide an extension of credit into two or more transactions to avoid the disclosure of an annual percentage rate pursuant to this paragraph.

(6) The number, amount, and the due dates or periods of payments scheduled to repay the indebtedness.

(7) The default, delinquency, or similar charges payable in the event of late payments.

(8) A description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates.

(b) Except as otherwise provided in this chapter, the disclosures required by subsection (a) shall be made before the credit is extended, and may be made by disclosing the information in the note or other evidence of indebtedness to be signed by the obligor.

(c) If a creditor receives a request for an extension of credit by mail or telephone without personal solicitation and the terms of financing, including the annual percentage rate for representative amounts of credit, are set forth in the creditor's printed material distributed to the public, or in the contract of loan or other printed material delivered to the obligor, then the disclosures required under subsection (a) may be made at any time not later than the date the first payment is due.

rescind.²⁴⁰ The Act spells out the rights and duties of the debtor when he elects to rescind.²⁴¹

E. Garnishment of Debtor's Earnings

Title III of the Act attempts to restrict creditors' rights to garnish the earnings of debtors. Earnings are broadly defined as "compensation paid or payable for personal services, whether denominated as wages, salary, commission, bonus, or otherwise, and includes periodic payments pursuant to a pension or retirement program."²⁴² Garnishment does not have the usual narrow definition; it includes "any legal or equitable procedure through which the earnings of any individual are required to be withheld for payment of any debt."²⁴³ In general, the maximum part of the total "disposable" earnings of an individual for any work week which is subjected to garnishment may not exceed twenty-five percent of his disposable "earnings for that week" or "the amount by which his disposable earnings for that week exceed thirty times the Federal minimum hourly wage prescribed by Section 6(a)(1) of the Fair Labor Standards Act of 1938 . . ." whichever is less.²⁴⁴ The term "disposable earnings" is the take-home pay after deductions "of any amounts required by law to be withheld."²⁴⁵

It is to be noted that although this garnishment section is predicated upon the idea of curbing predatory practices in the extension of credit,²⁴⁶ the Act is not limited to consumer credit transactions because the only

240. Act of May 29, 1968, Pub. L. No. 90-312, § 125.

241. Act of May 29, 1968, Pub. L. No. 90-312, § 125(b)-(e):

(b) When an obligor exercises his right to rescind under subsection (a), he is not liable for any finance or other charge, and any security interest given by the obligor becomes void upon such a rescission. Within ten days after receipt of a notice of rescission, the creditor shall return to the obligor any money or property given as earnest money, down payment, or otherwise, and shall take any action necessary or appropriate to reflect the termination of any security interest created under the transaction. If the creditor has delivered any property to the obligor, the obligor may retain possession of it. Upon the performance of the creditor's obligations under this section, the obligor shall tender the property to the creditor, except that if return of the property in kind would be impracticable or inequitable, the obligor shall tender its reasonable value. Tender shall be made at the location of the property or at the residence of the obligor, at the option of the obligor. If the creditor does not take possession of the property within ten days after tender by the obligor, ownership of the property vests in the obligor without obligation on his part for it.

(c) Notwithstanding any rule of evidence, written acknowledgment of receipt of any disclosures required under this title by a person to whom a statement is required to be given pursuant to this section does no more than create a rebuttable presumption of delivery thereof.

(d) The Board may, if it finds that such action is necessary in order to permit homeowners to meet bona fide personal financial emergencies, prescribe regulations authorizing the modification or waiver of any rights created under this section to the extent and under the circumstances set forth in those regulations.

(e) This section does not apply to the creation or retention of a first lien against a dwelling to finance the acquisition of that dwelling.

242. Act of May 29, 1968, Pub. L. No. 90-312, § 302(a).

243. Act of May 29, 1968, Pub. L. No. 90-312, § 302(c).

244. Act of May 29, 1968, Pub. L. No. 90-312, § 303(a).

245. Act of May 29, 1968, Pub. L. No. 90-312, § 302(b).

246. Act of May 29, 1968, Pub. L. No. 90-312, § 301.

exemptions from these restrictions are cases involving court orders for support of any person, bankruptcy court orders under Chapter XIII of the Bankruptcy Act and debts due for federal or state taxes.²⁴⁷ It would therefore appear that a tort judgment creditor would be subject to the same restrictions as a consumer creditor.

The Secretary of Labor is empowered to exempt garnishments from the restrictions of the Act if he determines that the state restrictions on garnishment "are substantially similar to those provided" in the Act.²⁴⁸ The Act does not annul, alter, affect or exempt state laws which may prohibit garnishments or provide for more limited garnishments than are provided for under the Act.²⁴⁹

The Act attempts to protect the employment rights of debtors by providing that no employer may discharge any employee because his earnings have been subjected to garnishment "for any one indebtedness."²⁵⁰ An employer who willfully violates this restriction shall be subject to a fine of \$1,000 or imprisonment for not more than one year, or both.²⁵¹

F. *Civil and Criminal Remedies*

The Act provides that any person who willfully and knowingly gives false or inaccurate information, fails to disclose information which he is required to disclose, uses any chart or table authorized by the Federal Reserve Board under section 107 "in such a manner as to consistently understate the annual percentage rate determined under Section 107(a) 1(A)," or otherwise fails to comply with any requirement imposed under the Act shall be fined not more than \$5,000 or imprisoned for not more than one year, or both.²⁵² It is suggested that only the clumsiest creditor will ever feel the effect of these criminal sanctions; alleged "clerical" errors will be the most likely defense gambit.

The civil liability sections of the Act hold more promise for the victimized debtor. Any creditor who fails to disclose to the debtor any information required under chapter 2 of the Act is liable to the debtor in an amount equal to the *sum* of twice the amount of the finance charge, although this liability shall not be less than \$100 nor more than \$1,000, and costs of the action together with a reasonable attorney's fee as set by the court when the debtor is successful in his action.²⁵³

The creditor may escape from liability if within fifteen days after discovering an error and prior to the institution of an action or the receipt of written notice of the error he notifies the debtor of the error and makes

247. Act of May 29, 1968, Pub. L. No. 90-312, § 303(b) and (c).

248. Act of May 29, 1968, Pub. L. No. 90-312, § 305.

249. Act of May 29, 1968, Pub. L. No. 90-312, § 307.

250. Act of May 29, 1968, Pub. L. No. 90-312, § 304(a).

251. Act of May 29, 1968, Pub. L. No. 90-312, § 304(b).

252. Act of May 29, 1968, Pub. L. No. 90-312, § 112.

253. Act of May 29, 1968, Pub. L. No. 90-312, § 130(a).

the appropriate adjustment in the account.²⁵⁴ Even if the creditor fails to discover any error he may still escape from liability if he "shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error."²⁵⁵

The Act also attempts to give the debtor a remedy against the assignee of a security interest in real property. The debtor may maintain his action against the assignee of the original creditor²⁵⁶

where the assignee, its subsidiaries, or affiliates were in a continuing business relationship with the original creditor either at the time the credit was extended or at the time of the assignment, unless the assignment was involuntary, or the assignee shows by a preponderance of evidence that it did not have reasonable grounds to believe that the original creditor was engaged in violations of this chapter, and that it maintained procedures reasonably adapted to apprise it of the existence of any such violations.

This articulation of a "holder in due course" seems to delineate an objective standard of good faith and knowledge; the pure heart and empty head test seems to be discarded.

It should be noted that the disclosure requirements under chapter 2 of the Act do not take effect until July 1, 1969, and the garnishment provisions are not effective until July 1, 1970.²⁵⁷

G. *Observations*

This Act, although a meaningful step forward, is not a panacea. Administrative enforcement of the Act is primarily the responsibility of the Federal Trade Commission,²⁵⁸ and it is doubtful whether this commission (or any other federal commission) can really police this area. Enforcement will come only from the enlightened use of the Act by consumers. As previously suggested, criminal sanctions will deter only the clumsiest creditor. The attorneys' fees provisions of the civil sanctions will probably be the most effective tool in the enforcement.

It is suggested that the entire purpose of the Act can be and will be frustrated by consumer credit dealers in their effective use of the concept of "cash price."²⁵⁹ Many dealers of appliances never mark their inventory on the showroom floor with any kind of price because their customers are more concerned with "how much down and how much a month?" If the salesman gives the customer a satisfactory answer to this question, he can

254. Act of May 29, 1968, Pub. L. No. 90-312, § 130(b).

255. Act of May 29, 1968, Pub. L. No. 90-312, § 130(c).

256. Act of May 29, 1968, Pub. L. No. 90-312, § 130(d).

257. Act of May 29, 1968, Pub. L. No. 90-312, § 504.

258. Act of May 29, 1968, Pub. L. No. 90-312, § 108.

259. Act of May 29, 1968, Pub. L. No. 90-312, § 128(a)(1).

write in any "cash price" he wants and thereby juggle the finance charges to give the customer the illusion that he is getting "a real good deal" on his charges. A customer who is getting this "real good deal" on financing charges is not going to see what other competitors are going to offer. Furthermore, the whole idea of competition between credit sale dealers may be unrealistic as applied to the slum area resident whose only real source of credit is the slum area dealer.

The Act betrays a strangely myopic view towards the concept of a "cooling-off period."²⁶⁰ The buyer has the right to rescind a security interest arrangement encumbering real property within three days, while the same victimized buyer has no similar right when he is buying goods. The slum area resident will not usually be a home owner, but he will be the victim of high pressure door-to-door salesmen selling vacuum cleaners, stereo sets, deep freezers, etc., of dubious value and overinflated price. This victim will have little, if any, real protection under the Act. It is also wondered if this three-day cooling-off period is long enough for the "home improvement" buyer to realize that his shiny dream of aluminum siding on his house may become a nightmare when he realizes what he will have to pay for these "improvements" which often prove defective before he has made his second payment.

III. SECURITY AGREEMENTS AND UNCONSCIONABILITY

The most fertile soil for the growth of unconscionable contracts is in the sales of "home improvements" and goods negotiated in the family home by "pitch men" who appeal to the larceny in the souls of most of us who desire to get something for nothing. Assume that a salesman for The Hipressure Food Company visits John Consumer and his wife in their home. The salesman "shows" John that he can purchase a deep freeze for only \$400 payable in "easy" monthly installments. Then the salesman tells John that Hipressure will pay John \$25 in cash (or deduct a like amount from the monthly payments) for each buying customer that John refers to Hipressure and that John will probably be able to purchase this deep freeze for nothing in this manner and may even make a profit. John and his wife sign a number of finely printed contracts, many of which are incomplete, in a hurried manner because of the fast paper shuffling of the salesman. Later John discovers that he is paying credit charges of two or three times the value of his purchase and that the referral plan discussed by the salesman is not mentioned in the agreement, or if it is mentioned, it is hedged about with so many restrictions that it is valueless. Let us assume further John and his wife are functional illiterates or literate only in a foreign language. Will or should a court invalidate this contract on the grounds of unconscionability by considering the totality of the fact pattern? Or to put it in another manner, must all of the above facts be present before a court will term the credit contract unconscionable?

260. Act of May 29, 1968, Pub. L. No. 90-312, § 125.

Somewhat surprisingly, the courts have given a very liberal construction to the unconscionability rule of the Code in favor of the consumer. In the case of *Frostifresh Corporation v. Reynoso*²⁶¹ a Spanish-speaking couple dealt with a Spanish-speaking salesman of a freezer company. The contract was in English and it was not translated or explained to the couple in Spanish; the inference was that the couple could not read English. The cash sale price was \$900, and a credit charge of \$245.88 was added. The cost of the appliance to the seller was \$348. The seller claimed attorney's fees of \$227.35 and a late payment charge of \$22.87. Fraud was not used as a defense. The court held that:²⁶²

[T]he sale of the appliance at the price and terms indicated in this contract is shocking to the conscience. The service charge, which almost equals the price of the appliance is in and of itself indicative of the oppression which was practiced on these defendants. Defendants were handicapped by a lack of knowledge, both as to the commercial situation and the nature and terms of the contract which was submitted in a language foreign to them.

The court then granted judgment against the buyers for \$348 (the seller's cost) and denied recovery of any other damages. The New York Supreme Court, Appellate Division,²⁶³ affirmed the finding of unconscionability but held that the seller should recover its net costs for the refrigerator-freezer, plus a reasonable profit and plus trucking and service charges necessarily incurred and reasonable finance charges. The court remanded the case for a new trial limited to an assessment of the seller's damages.

It is submitted that neither court properly assessed damages. The trial court, by limiting recovery to the seller's cost, unduly penalized the seller by not awarding it the out-of-pocket expense of trucking and servicing. The Appellate Division, by awarding a reasonable net profit and reasonable finance charges, has unduly rewarded the seller. Under this holding, the sellers are encouraged to enter into unconscionable contracts on the theory that most buyers will pay without litigation and those few who do litigate will still be forced to pay a reasonable profit and reasonable finance charges. The seller cannot lose under this policy.

A much more buyer-oriented approach was taken by the New Hampshire Supreme Court in the case of *American Home Improvement, Inc. v. MacIver*.²⁶⁴ The plaintiff home improvement company entered into a contract with the defendant homeowners to sell and install fourteen combination windows and a door and to "flintcoat" the walls of the home for a total price of \$1,759. The homeowners signed a credit application which

261. 52 Misc. 2d 26, 274 N.Y.S.2d 757 (Dist. Ct. Nassau County 1966). See Comment, *Unconscionability—The Code, The Court and The Consumer*, IX BOSTON COLL. IND. & COMM. L. REV. 367 (1968); Annot., 14 A.L.R.3d 330 (1968).

262. *Id.* at 27, 274 N.Y.S.2d 757.

263. *Frostifresh Corp. v. Reynoso*, 54 Misc. 2d 119, 281 N.Y.S.2d 964 (Sup. Ct. 1967).

264. 105 N.H. 435, 201 A.2d 886 (1964).

contained a blank promissory note. The credit application provided for the total amount due, the number of months of payments and the amounts of monthly payments, but it did not mention the rate of interest. When the defendants received a copy of the approved credit application it showed that their monthly payments were to cover principal, interest and life and disability insurance. The plaintiff started work, but the defendants notified it to stop after only a negligible amount of work had been done. The plaintiff paid a sales commission of \$800 to the salesman. The court held that the nonwilful failure of the seller to disclose the amount of finance charges on the contract was a violation of the New Hampshire statutes which require this disclosure, and that it would carry out the purpose of the statute to deny any recovery to the seller. In addition to this reason, the court noted that if the contract had been performed by the seller, the buyers would have paid \$2,568.60 for goods and services worth \$959, the difference consisting of a sales commission of \$800 and interest and carrying charges of \$809.60. The court then held,²⁶⁵

Inasmuch as the defendants have received little or nothing of value and under the transaction they entered into they were paying \$1,609 for goods and services valued at far less, the contract should not be enforced because of its unconscionable features.

In this case it is to be noted that there was no testimony indicating that the homeowners were illiterate or naive, and no testimony indicating the nature of the salesman's actions. The holding seems based squarely upon a theory that when there is a vast disparity between the cash purchase price and the time-price differential, the contract is unconscionable. It is suggested that if the work had been completed, the court might perhaps have awarded a *quantum meruit* recovery for the work under the unconscionability part of the decision, but would have denied any recovery at all under the New Hampshire disclosure statute.

In the case of *In re State v. ITM, Incorporated*,²⁶⁶ a New York trial court cited the *American Home Improvement* case with approval for the proposition that the "Supreme Court of New Hampshire refused to enforce a contract unconscionable on grounds of price alone."²⁶⁷ In the New York case, a number of affiliated companies sold broilers, vacuum cleaners and color television sets to consumers under a "referral" scheme which "pyramided" or "chained" the customer referrals in such a manner that the consumers supposedly were to pay nothing for their purchases and were to earn large profits. Simple mathematics disclosed that the chain referral system could not work; the sellers knew this but the buyers did not. The buyers signed retail installment sales contracts for amounts from two to six times the cost of the units to the sellers. The sellers then immediately assigned the retail installment contracts to various finance

265. *Id.* at 439, 201 A.2d at 889.

266. 52 Misc. 2d 39, 275 N.Y.S.2d 303 (Sup. Ct. N.Y. County 1966).

267. *Id.* at 54, 275 N.Y.S.2d at 321.

companies and banks. The State of New York sought to enjoin these companies from continuing their operations and from trying to enforce their existing sales contracts. The court granted the injunction and declared the contracts void on the basis that they did not comply with the New York personal property statutes, that they contravened the New York lottery statutes and that they were unconscionable under the U.C.C. In dealing with the question of unconscionability the court stated,²⁶⁸

The respondents fraudulently misrepresented that the products were not obtainable elsewhere at these prices. The goods were available elsewhere and at much lower prices. It is clear that these excessively high prices constituted "unconscionable contractual provisions" within the meaning of subdivision 12 of section 63 of the Executive Law. . . . But, even if the prices charged were not unconscionable per se, they were unconscionable within the context of this case. [The court cited section 2-302 of the U.C.C.]

The court, after citing the *American Home Improvement* case for the rule that a contract will be unconscionable when there is a vast disparity between what the buyer receives and what he is paying, stated,²⁶⁹

The same disparity exists in the transactions in the instant case to clearly render such transactions unconscionable and when the deceptive practices are also considered, there can be no doubt about the unreasonableness and unfairness of these agreements.

The court finally forestalled the objections that might be raised by even the most fervent follower of the *caveat emptor* school,²⁷⁰

No longer do we believe that fraud may be perpetrated by the cry of *caveat emptor*. We have reached the point where "Let the buyer beware" is a poor business philosophy for a social order allegedly based upon man's respect for his fellow man. Let the seller beware, too! A free enterprise system not founded upon personal morality will ultimately lose freedom. We also believe that it is right, proper, just and equitable to tell the consumer, clearly and adequately, that he is entering into a contract and that he is personally liable for the entire contract price and that he will be required to make stipulated monthly payments, plus carrying charges, etc., in language that the least educated person can understand. And if he chooses not to do so, but instead lures an innocent person into a predicament where a heavy obligation is incurred due to the fraudulent means exercised by the representative, should the innocent victim suffer and hold harmless the seller and thereby reward him for his highhanded conduct?

268. *Id.* at 53, 275 N.Y.S.2d at 321.

269. *Id.* at 54, 275 N.Y.S.2d at 321.

270. *Id.*

It should be noted that consumers who have fallen into the trap of being induced to enter into purchases as a result of the referral schemes used by salesmen, may be relieved from liability upon the ground that the scheme is a lottery in addition to the defense of its unconscionability.²⁷¹

A year after the decision in the *ITM* case, another New York court was confronted with a case wherein the assignor of the plaintiff finance company sold a used automobile for a purchase price of \$939.75 plus a credit service charge of \$242.47.²⁷² The buyer alleged that the car was defective, and that he spent \$570 to repair it. The court stated that excessively high prices may constitute unconscionable contractual provisions within the meaning of the U.C.C.²⁷³ The court cited the *ITM* and *American Home Improvement* cases and the case of *Williams v. Walker-Thomas Furniture Co.*²⁷⁴ as authority for this statement. Then, in a completely inconsistent manner, the court quoted extensively from the *Williams* case (which did not involve excessively high prices) for the proposition that the buyers when sued by the finance company "are entitled to a reasonable opportunity to present evidence as to its [the sales transaction's] commercial setting, purpose and effect to aid the court in determining whether the contract was as a matter of law unconscionable."²⁷⁵

In the *Williams* case a furniture dealer sold a stereo set for \$514.95 on credit to a woman who was receiving welfare payments of \$218 per month for herself and seven children. The dealer had knowledge of the consumer's financial status. The consumer owed the dealer \$164 as the balance of her prior purchases when she bought the stereo, and she had made purchases totaling \$1,800 over the years from this dealer. The security agreement under which she bought the stereo provided that her payments would be prorated over the purchase price of the stereo and over all other purchases made by her. Each new purchase automatically became subject to a security interest arising out of her previous purchases, and upon default in her payments the dealer had the right to repossess all of the goods purchased. The consumer defaulted, and the dealer sought to replevy all of her purchases. The events took place before the adoption of the U.C.C. in the District of Columbia, and the trial court denied any relief to the consumer on the grounds that there was no legislation giving the courts power to invalidate the dealer's actions which were characterized as smacking of "sharp practice and irresponsible business dealings."²⁷⁶

271. *E.g.*, *M. Lippincott Mortgage Investment Co. v. Childress*, 204 So.2d 919 (Fla. 1st Dist. 1968); *In re State v. ITM, Inc.*, 52 Misc. 2d 39, 275 N.Y.S.2d 303 (Sup. Ct. N.Y. County 1966); *Sherwood & Roberts-Takima, Inc. v. Leach*, 67 Wash. 2d 630, 409 P.2d 160 (1966); see Comment, Let the "Seller" Beware—Another Approach to the Referral Sales Scheme, 21 U. MIAMI L. REV. 861 (1968).

272. *Central Budget Corp. v. Sanchez*, 53 Misc. 2d 620, 279 N.Y.S.2d 391 (Civ. Ct. 1967).

273. *Id.* at 621, 279 N.Y.S.2d at 392.

274. 350 F.2d 445 (D.C. Cir. 1965).

275. 279 N.Y.S.2d 391, 393 (1967).

276. 350 F.2d 445, 448 (D.C. Cir. 1965).

The court of appeals reversed, holding that even though the U.C.C. was adopted subsequent to the transactions involved, the unconscionability rule of the Code could be adopted by the court in the exercise of its powers to develop the common law of the District of Columbia.

The court then attempted to fill the void left by the Code in its failure to define the concept of unconscionability,²⁷⁷

Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party. Whether a meaningful choice is present in a particular case can only be determined by consideration of all the circumstances surrounding the transaction. In many cases the meaningfulness of the choice is negated by a gross inequality of bargaining power. The manner in which the contract was entered is also relevant to this consideration. Did each party to the contract, considering his obvious education or lack of it, have a reasonable opportunity to understand the terms of the contract, or were the important terms hidden in a maze of fine print and minimized by deceptive sales practices? Ordinarily, one who signs an agreement without full knowledge of its terms might be held to assume the risk that he has entered a one-sided bargain. But when a party of little bargaining power, and hence little real choice, signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent, or even an objective manifestation of his consent, was ever given to all the terms. In such a case the usual rule that the terms of the agreement are not to be questioned should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld.

In determining reasonableness or fairness, the primary concern must be with the terms of the contract considered in light of the circumstances existing when the contract was made. The test is not simple, nor can it be mechanically applied. The terms are to be considered "in the light of the general commercial background and the commercial needs of the particular trade or case." Corbin suggests the test as being whether the terms are "so extreme as to appear unconscionable according to the mores and business practices of the time and place." . . . We think this formulation correctly states the test to be applied in those cases where no meaningful choice was exercised upon entering the contract.

The court's emphasis of the phrase "meaningful choice" is a troublesome one. In the typical contract of adhesion (which is more or less uniform throughout the seller's industry), the consumer does not have a meaningful choice. However, did all or a majority of furniture dealers in the District of Columbia use the same boiler-plate form as was discussed

277. *Id.* at 449.

by the court? The opinion failed to answer this question. The opinion failed to discuss any facts of overreaching by the dealer, other than the security agreement lien on all purchases, and any lack of education of the consumer—the fact that the buyer was on the relief rolls does not necessarily indicate a lack of education or ignorance. If a lack of “bargaining power” is to be the test, then it is doubtful that any person who buys furniture on credit has any real bargaining power. If one considers the large depreciation inherent in the furniture trade on the consumer level, the fact that a dealer demands the right to repossess additional furniture might not be too unreasonable.²⁷⁸

The unconscionability doctrine was applied to a most unusual type of credit contract in *W. T. Grant Co. v. Walsh*.²⁷⁹ A husband and wife agreed to pay \$246 over a 24-month period for coupons worth \$200 issued by W. T. Grant Co. The contract provided that if the coupons were lost, stolen or destroyed, or detached from the coupon book prior to use, the customer would still be liable for the remainder of the payments. The coupons could be applied toward the purchase of goods from the issuer, W. T. Grant Company. In effect the issuer was selling coupons on credit rather than goods themselves. The husband and wife understood that they were applying for the usual kind of charge account upon which there would be no payment due until purchases of goods were made and then the payment would not exceed ten dollars per month. The couple's beliefs were the result of misrepresentations made by Grant's employee. The court noted that Grant was charging interest on its customers' accounts before any purchases were made, and Grant was claiming the right to collect even if the coupons were never used or if they were lost, stolen or destroyed. The court refused any recovery to Grant and stated,²⁸⁰

Its [Grant's] greed has carried it beyond the bounds of an unconscionable agreement to a point where its desire to even economize on clerical expenses thwarts its own proofs.

It is difficult to imagine a more one-sided scheme for the enrichment of a commercial establishment at the expense of a potential customer. . . . The court is of the opinion that this plan is, in addition to its other faults, against public policy.

Section 2-302 of the Code provides that the court “may limit the application of any unconscionable clause as to avoid any unconscionable result.” A good illustration of an application of this clause appeared in the case of *Robinson v. Jefferson Credit Corp.*,²⁸¹ in which Robinson purchased an automobile under a security agreement. Two weeks after Robinson defaulted in his payments, the finance company repossessed his car.

278. See Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445 (1968).

279. 100 N.J. Super. 60, 241 A.2d 46 (Dist. Ct. 1968).

280. *Id.* at 63, 241 A.2d at 49.

281. 4 U.C.C. Rept. Serv. 15 (N.Y. Sup. Ct. Nassau County 1967).

Robinson paid the late payment plus charges, but the finance company failed to return his car. Robinson was unable to obtain co-signers on the contract, and the company also claimed it was unable to locate Robinson's place of employment. Robinson made two further defaults in his payments while the finance company had possession of the car. Robinson sued to recover his automobile and the court held that²⁸²

It is difficult to ascertain a rational upholding defendant's right to collect the past due payments plus late charges and a repossession fee and, at the same time, fail to return the repossessed car. It is also difficult to understand defendant's contention that repossession may not now be ordered, for plaintiff has failed to make the last two payments due, for these last two payments became due while the car was being withheld from plaintiff's possession.

Unconscionable conduct is prescribed by the Uniform Commercial Code, and defendant's conduct herein, even if allowed under the contract between the parties, cannot withstand comparison to the requisite standard of commercially reasonable conduct required under the Code.

IV. ACCELERATION OF THE DEBT FOR DEFAULT OR INSECURITY

Let us assume that the security agreement and promissory note signed by John Consumer in his credit purchase of an air-conditioner and refrigerator from Merchants Appliance Company provides that the holder of the chattel paper may accelerate the entire indebtedness in the event of default in making installment payments, or for failure to maintain the collateral in a proper manner, or upon failure of John Consumer to give additional collateral. The chattel paper²⁸³ may also provide that Merchants may accelerate the entire indebtedness at any time when it deems itself insecure. The presence of some or all of these clauses create two problems, (a) what effect they have on negotiability of the promissory note, which is important if the finance company holder of the note claims that it is a holder in due course, and (b) whether there are any limitations on the right of Merchants Appliance Company (or the finance company which has purchased the note from Merchants) to exercise this acceleration.

Prior to the Code, it was the general rule that a clause allowing the holder to accelerate the entire indebtedness upon a default by the maker or upon the happening of some objective event did not make the note payable at an indefinite time and it would not affect its negotiability.²⁸⁴ Clauses which allowed the holder to accelerate at will or when he felt himself to be insecure were usually held payable at an indefinite time sub-

282. 4 U.C.C. Rept. Serv. 15, 16 (N.Y. Sup. Ct. Nassau County 1967).

283. U.C.C. § 9-105(1) (b).

284. W. BRITTON, *BILLS AND NOTES* 57-68 (2d ed. 1961).

ject to the subjective will of the holder and therefore non-negotiable.²⁸⁵ The Code now provides that an instrument is payable at a definite time if by its terms it is payable "at a definite time subject to any acceleration."²⁸⁶ The phrase "any acceleration" includes acceleration at the option of the maker or holder or an acceleration which is automatic upon the occurrence of some event.²⁸⁷

As a corollary of this rule, the Code provides that any clause in an agreement which gives a party the right to accelerate payment or performance or to require collateral or additional collateral "at will or when he deems himself insecure" shall be construed to mean that the party has this power "only if he in good faith believes that the prospect of payment or performance is impaired."²⁸⁸ The burden of establishing a lack of good faith is on the party against whom the power is exercised.²⁸⁹ This good faith requirement is designed to act as a fetter upon the mere whim or caprice of the creditor. However, with the burden of proof placed upon the debtor it is to be doubted that this good faith limitation will have much practical value.

Intimately related to this concept of giving additional collateral when the creditor deems himself to be insecure, is the Code provision that a security interest cannot attach under an after-acquired property clause to consumer goods unless the debtor acquires rights in these goods within ten days after the secured party gives value.²⁹⁰ Under this rule it would appear that inasmuch as the security interest could not attach to consumer goods acquired more than ten days after the secured party gave value, any acceleration clause in consumer paper which provided that the holder could accelerate the entire indebtedness if the consumer-debtor should fail to supply additional collateral in consumer goods should be ineffective unless the consumer debtor acquired rights in the goods within ten days after the secured party gave value.²⁹¹ It should be noted, however, that this rule may be more or less circumvented by a provision in the note and security agreement which subjects other consumer goods already owned by the consumer to the lien of the security agreement. A clause of this type will be effective unless it is so oppressive that a court determines that it is unconscionable in the light of *Williams v. Walker-Thomas Furniture Company*, which has been discussed.²⁹²

V. FINANCE COMPANIES VIS-À-VIS JOHN CONSUMER

John Consumer's complaints about breach of express and implied warranties will be of little avail against a merchant who has gone out of

285. *Id.*

286. U.C.C. § 3-109(1)(c).

287. U.C.C. § 3-109, Comment 4.

288. U.C.C. § 1-208.

289. *Id.*

290. U.C.C. § 9-204(4)(b).

291. Of course, a broad acceleration clause allowing the holder to accelerate when he deems himself insecure will circumvent this defense.

292. See notes 274-78 *supra*

business or has gone bankrupt since the sale, although his complaints will often appear as defenses when he is threatened with suit (or is sued) by a finance company which bought John's chattel paper (note and security agreement) from the Merchant. Let us assume that John Consumer purchased the air-conditioner and refrigerator from Merchants Appliance Company. John made a small down payment and signed a promissory note and some kind of security agreement for the remainder of the purchase price. The security agreement and promissory note were probably on forms supplied by the Fabulous Finance Company, and this same finance company probably ran a credit check on John before purchasing the chattel paper from Merchants Appliance Company. Neither the air-conditioner nor the refrigerator has met the express and implied warranties made by Merchants Appliance, but Merchants has gone bankrupt, and John has refused to make any more payments. The finance company has now filed suit against John Consumer and it claims that it is free of any defenses which John may have against Merchants Appliance because (a) it is a holder in due course; (b) John Consumer in the security agreement agreed that he would not assert any defenses as to quality as against any assignee of the chattel paper; (c) the security agreement disclaimed any and all express and implied warranties; and (d) on any one, or all, of these grounds, Fabulous Finance Company takes free of John's defenses.

A. *Holder in Due Course*

Fabulous Finance Company must take the promissory note for value, in good faith and without notice of any defense against it in order to be a holder in due course.²⁹³ Under the older orthodox view the fact that Fabulous Finance prepared or supplied the promissory note and security agreement form used by Merchants Appliance Company and ran a credit check on John Consumer would not be enough to show that Fabulous took with notice or in bad faith.²⁹⁴ However, the more modern view is that when a finance company is closely connected with the vendor of the goods it will be deprived of any holder in due course standing under the view that its close connection either gives it notice of a defense or it will not be a good faith holder. The cases are unsatisfactory from an analytical standpoint—there seems to be a piling of inference upon inference to reach a pre-determined end.²⁹⁵ They may perhaps be justified on a social engineering basis when confined to consumer transactions. Unfortunately, they have spilled over into sales by merchants to merchants, and merchants do not need an umbrella of protections which may be necessary over the heads of consumers.²⁹⁶

293. U.C.C. §§ 3-302 to -304.

294. W. BRITTON, *BILLS AND NOTES* §§ 100-112 (2d ed. 1961).

295. *Unico v. Owen*, 50 N.J. 101, 232 A.2d 405 (1967); Comment, *Unico v. Owen: Consumer Finance Companies as Holders in Due Course Under the U.C.C.*, 54 VA. L. REV. 678 (1968); *HIMC Investment Co. v. Siciliano*, 37 U.S.L.W. 2172 (N.J. Super. Ct. 1968).

296. See, e.g., *Mutual Fin. Co. v. Martin*, 63 So.2d 649 (Fla. 1953); *National State Bank v. Robert Richter Hotel, Inc.*, 186 So.2d 321 (Fla. 3d Dist. 1966); *National State Bank v.*

A few states have legislated in this area by providing that a finance company may not claim holder in due course status in consumer finance transactions.²⁹⁷ Others have provided that the consumer has a "complaint period" or "cooling-off period" of ten or fifteen days in which to complain about the quality of the goods. The finance companies are required to give notice to the consumer of his right to complain within this statutory period, and, if he does so, the finance company will not be able to claim any rights against the consumer.²⁹⁸ It may be suggested that even the most shoddy merchandise will stand up for ten or fifteen days, and this complaint period will be of little use.²⁹⁹

There may be a practical way for merchants to circumvent these statutes and the holder in due course problem. John Consumer desires to purchase an air-conditioner and refrigerator from Merchants Appliance Company on a credit basis. Merchants tells John that it is not equipped to handle all the details involved with credit sales, and it suggests that he visit a small loan company down the street. John signs a security agreement with the small loan company which encumbers all of his furniture (including perhaps the air-conditioner and refrigerator). John explains the purpose of his loan, and the small loan company tells him "that is your business, you may spend the money as you like." The loan company gives John the cash or a check made payable to him, and he turns the cash or indorses the check over to Merchants Appliance Company. If the consumer goods are defective, the loan company is not concerned; John must deal with Merchants and if it goes bankrupt, John will bear the loss. If John defaults on his loan, the loan company will take possession of his furniture (including the air-conditioner and the refrigerator).

B. *Waiver of Defenses*

The Code provides that unless a statute or decision of the state establishes a different rule for buyers or lessees of consumer goods, the buyer may agree that he will not assert against an assignee of the security agreement any claim or defense which he may have against the seller or lessor.³⁰⁰ This lender-oriented protective device carries the seeds of its own destruction because a court may accept the offer contained in this section and hold that this waiver clause is ineffective in consumer goods cases. Or the court may simply hold that the "assignee" is so closely

Robert Richter Hotel, Inc., 188 So.2d 18 (Fla. 3d Dist. 1966); and Industrial Credit Co. v. Mike Bradford & Co., 177 So.2d 878 (Fla. 3d Dist. 1965).

297. Jordan & Warren, *The Uniform Consumer Credit Code*, 68 COLUM. L. REV. 387, 433-38 (1968); Alcoa Credit Co. v. Nickerson, 5 U.C.C. REPT. SERV. 152 (Mass. App. Div., N.D. 1968). In Pennsylvania, the finance company which knowingly finances the sale of a motor vehicle cannot be a holder in due course. Casey v. Philadelphia Auto Sales Co., 428 Pa. 155, 236 A.2d 800 (1968).

298. THE LAW AND THE LOW INCOME CONSUMER 249-51 (C. Katz ed. 1968).

299. See Jordan & Warren, *supra* note 297 at 434-35, for additional criticisms of this "complaint" rule.

300. U.C.C. § 9-206(1).

connected to the merchant-vendor that the assignee cannot be considered as taking in good faith and without notice. The same approach used in the holder in due course cases can render this section completely ineffective, particularly in the consumer goods area.

An example of this approach was presented in the recent pre-Code case of *Unico v. Owen*.³⁰¹ Universal Stereo Corporation sold stereo albums (to be delivered over a five and one-half year period) and a stereo record player under a retail installment sales contract. The cash price was listed at \$698 and the buyers paid \$30 down. The balance of \$668, plus a fee of \$1.40 and a time-price differential of \$150.32, left a time balance of \$819.82 to be paid in 36 equal monthly installments of \$22.77. The buyers signed a promissory note which was indorsed with recourse to Unico, a finance company which was formed expressly for the purpose of financing Universal. The installment contract was a maze of small print in favor of Universal. Universal had five and one-third years to deliver all of the records, while the customer had to pay in three years. The buyers received twelve stereo albums and the record player but no further deliveries were made, and Universal became insolvent. Unico then sued the consumers for the balance due on the note, plus penalties and a twenty percent attorney's fee. The buyer claimed a failure of consideration.

Unico claimed that even if it were not a holder in due course (as found by the trial court) it should recover under a clause in the installment contract wherein the buyers agreed not to assert any default of the seller (Universal) as a defense or counterclaim to a suit by the assignee (Unico). The court held that this clause was "an unfair imposition on a consumer goods purchaser and is contrary to public policy"³⁰² on the grounds that it is opposed to the policy of the N.I.L., the assignment statute of New Jersey and the policy of New Jersey to protect conditional vendees from imposition by conditional vendors and installment sellers. The court then noted that sections 9-206(1) and 2-302 of the U.C.C. are closely linked and constitute an intention "to leave in the hands of the courts the continued application of common law principles in deciding in consumer goods cases whether such waiver clauses as the one imposed on Owen in this case are so one-sided as to be contrary to public policy."³⁰³ The court then held that the waiver clause was unenforceable and invalid against the buyer.

C. *Disclaimer of Warranties*

Section 9-206(2) of the Code states that "when a seller retains a purchase money security interest in goods the Article on Sales . . . governs the sale and any disclaimer, limitation or modification of the seller's warranties." This sub-section is designed to cover cases in which John Con-

301. 50 N.J. 101, 232 A.2d 405 (1967).

302. *Id.* at 123, 232 A.2d at 417.

303. *Id.* at 125, 232 A.2d at 418.

sumer has entered into a sales agreement with Merchants Appliance Company which contains express warranties and then Merchants uses a security agreement form which disclaims all warranties. The separate security agreement disclaimer may not take away warranties given by the separate sales agreement. However, if Merchants uses one written form which combines the sales aspects and the financing aspects, it may disclaim warranties in accordance with the provisions of article 2.³⁰⁴ If this approach is taken, it would appear that Fabulous Finance Company would step into the shoes of Merchants Appliance Company, and if the disclaimer destroys any remedy of John Consumer against Merchants it will have the same effect in the hands of Fabulous Finance. John's only weapons then will be that the bargain was unconscionable and in bad faith in accordance with the *Unico*³⁰⁵ holding.

D. *Redemption Rights*

Redemption rights of John Consumer whose refrigerator and air-conditioner have been repossessed by Merchant Appliance Company will probably be of small concern to John or his lawyer. If one is financially able to redeem, he probably will not default in his installment payments and the redemption problem will not arise. However, if we assume that John Consumer did default in his monthly installments but has enjoyed a windfall we will be concerned with his rights to redeem. John Consumer has an absolute right to redeem at any time before Merchants Appliance Company has sold, leased or otherwise disposed of the goods under section 9-504, unless John has otherwise agreed in writing with Merchants *after* his default or if John fails to object in writing within thirty days after John receives written notice from Merchant Appliance Company that it intends to retain the refrigerator and air-conditioner in satisfaction of the obligation.³⁰⁶ In the ordinary case it would probably prove advantageous to John Consumer if Merchant Appliance Company would be willing to keep the repossessed collateral in full satisfaction for the debt because the resale value of used consumer goods would probably be less than the remaining balance of the debt, the reasonable expenses of retaking, holding, preparing for sale, selling, and attorney's fees if provided for in the agreement.³⁰⁷ This might not be true, however, if John Consumer has paid a large portion of the debt. The Code recognizes this fact by providing that if John Consumer has paid sixty percent of the cash price in a purchase money security interest in consumer goods or has paid sixty percent of the loan in which consumer goods were given as collateral and has not after default renounced or modified his rights, the lender *must* sell it at private or public sale. If the lender fails to do so, within thirty

304. U.C.C. § 9-206, Comment 2.

305. *Unico v. Owen*, 50 N.J. 101, 232 A.2d 405 (1967).

306. U.C.C. §§ 9-504 to -506.

307. U.C.C. § 9-504(1)(a) and (b).

days after repossession, the debtor, John Consumer, may sue the lender, Merchants Appliance, for conversion³⁰⁸ or for "an amount not less than the credit service charge plus ten percent of the principal amount of the debt or the time price differential plus ten percent of the cash price."³⁰⁹ The phrase "not less than" in the above rule means that this is the minimum recovery for John Consumer; he may receive more in an appropriate case.³¹⁰ This rule requires the lawyer for John Consumer to compute the possible damages under a trover theory and under the Code theory and then to choose the more advantageous remedy.

In addition to these monetary remedies, the Code gives John Consumer the right to apply for an injunction restraining Merchants Appliance from acting contrary to John's rights and ordering Merchants to follow the requirements of the Code.³¹¹ In accordance with the general rule prior to the Code, John Consumer may not waive, renounce or modify his rights to redeem and to demand compliance with these protective rules in the original security agreement. He may only do so after default by a separate written instrument.³¹²

VI. FIXTURES

Ordinarily, any perfection and remedy problems dealing with fixtures are of primary concern to the merchant, purchase money lenders and owners and mortgagees of the land, rather than to the consumer who happens to buy fixture goods on a purchase money security interest arrangement with the merchant. For example, John Consumer purchases a room air-conditioner from Merchants Appliance Company for installation in the wall of John's home. John purchased the air-conditioner under a purchase money security interest agreement given to Merchants Appliance Company. In order for Merchants to perfect its security interest against an existing mortgagee of John's home and any subsequent mortgagee or judgment lien creditor who has secured a judgment against John Consumer, Merchants Appliance Company should file, in the real property records of the county in which the land is located, a financing statement which describes the fixture and (in most states) simply gives a street address for the real property.³¹³ If John Consumer should default in his payments, Merchants Appliance Company may repossess the air-conditioner, sell it and hold John for the balance of the unpaid purchase price.³¹⁴ If we assume that John has made some payments and the machine is relatively new with mere ordinary wear and tear, the balance may not be too great a sum.

308. U.C.C. § 9-505.

309. U.C.C. § 9-507(1).

310. U.C.C. § 9-507, Comment 1.

311. U.C.C. § 9-507(1).

312. U.C.C. §§ 9-506 and 9-505.

313. U.C.C. §§ 9-313(2) and (3), 9-401 and 9-402.

314. U.C.C. §§ 9-313, 9-503 and 9-504(2).

The result under the Florida version of section 9-313 of the Code should be compared. In Florida the purchase money vendor (or lender) may not secure a purchase money security interest which has priority as against "any person with an interest in the real estate at the time the security interest in the goods is perfected or at the time the goods are affixed to the real estate," unless he consents in writing or disclaims an interest in the goods as fixtures.³¹⁵ It would appear, therefore, that if the existing mortgagee failed to consent or disclaim the purchase money vendor could not repossess the air-conditioner upon default by John Consumer and John would then be liable for the entire unpaid balance, without any allowance for the repossession sales price as would be true under the original version of this section. This Florida version of section 9-313, which was obviously designed to protect mortgagees of land at the expense of purchase money vendors (or lenders) of goods, may also adversely affect the interests of consumers in the event of default. It may also have the more immediate and serious effects of inhibiting the credit sales of fixtures to consumers and causing an increase in the financing costs of these purchases because of increased losses suffered by merchants and lenders. The economic effect may be more serious than the legal one.

VII. CONCLUSION

The U.C.C. has been criticized for its alleged lack of sufficient provisions designed to protect the consumer, and the critics have advocated that this alleged failure should be cured by the adoption of a Uniform Consumer Credit Code or by other consumer-oriented legislation.³¹⁶ As a minority of one, the author suggests that these objections may be proved groundless in the light of experience within the next few years. In fifty-one American jurisdictions, the U.C.C. has been effective in only twenty-three prior to 1965. Of the twenty-eight jurisdictions in which the Code was made effective during the years 1965-1968, four jurisdictions have lived with it for less than one year, nine for less than two years, eight for less than three years and seven for less than four years.³¹⁷ The relatively small number of consumer cases arising under the unconscionability rule of the Code have been favorable to the consumer, indicating that the courts have not had as much trouble with the Code as have the academic critics. It is believed that the unconscionability and good faith rules of the Code are sufficiently broad to enable the courts to police oppressive sales and

315. FLA. STAT. § 679.9-313 (1967).

316. E.g., Robinson, *The Uniform Consumer Credit Code*, 22 PERSONAL FIN. L. Q. REP. 118 (1968); Dennon, *The Uniform Consumer Credit Code Bombshell*, 22 PERSONAL FIN. L. Q. REP. 125 (1968); Skilton & Helstad, *Protection of the Installment Buyer of Goods Under the Uniform Commercial Code*, 65 MICH. L. REV. 1465 (1967); Jordan & Warren, *The Uniform Consumer Credit Code*, 68 COLUM. L. REV. 387 (1968); Graham, *The U3C*, 42 FLA. B. J. 1043 (1968).

317. UNIFORM LAWS ANN., UNIFORM COMMERCIAL CODE (Supp. 9, 1967).

credit sales to consumers. We ought to give the Code a sufficient trial period before we decide that it does not protect the consumer.

We ought to consider also the complete "ecology" of the consumer credit field from a sociological, economic, psychological, commercial, educational and legal viewpoint before placing new restrictions on the lending class. A solely law-oriented approach may result in a "cure" which effectively denies credit to the vast majority of low-income consumers and even higher interest rates to a small minority of their neighbors. Low-income consumers want television sets and appliances *now*, and the results could be chaotic if they are deprived, in a period of rising expectations, of sources of credit as the unforeseen result of efforts by well-intentioned persons. It is also believed that it is a mistake to frame legislation for all credit sale consumers (middle class, low income and relief recipients) based upon the peculiar problems unfortunately present in the ghetto. The upper or middle class consumer who finances his automobile through a bank loan does not need the same protections which may be needed by a low-income consumer buying a used automobile financed by a gouging ghetto financing agency. The cure ought to be tailored to fit the problems. Unwise tampering with our credit economy could be a disaster for it and for all consumers.³¹⁸

318. For an excellent discussion of the consumer-credit regulation problem see Kripke, *supra* note 278. But see Greenwalt, *One-Stop Service for Poor Consumer*, 4 TRIAL No. 4, 38 (1968) for a contrary viewpoint.